

School District of the
City of Muskegon Heights

REPORT ON FINANCIAL STATEMENTS
(with required supplementary information)

Year ended June 30, 2006

School District of the City of Muskegon Heights

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**Muskegon Heights Public Schools
Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2006**

This section of Muskegon Heights Public Schools' annual report represents an overall review of the School District's financial activities for the fiscal year ended June 30, 2006. Please review in conjunction with the financial statements and notes to the financial statements to enhance an understanding of the district's financial performance.

The Governmental Accounting Standards Board (GASB) in their Statement No. 34 Basic Financial Statements adopted this reporting model – and Management Discussion and Analysis (MD&A) – for State and Local Governments issued in June of 2000. Certain comparative information between the current year and the prior year is required to be presented in the MD&A.

Overview of the Financial Statements

This annual report consists of four parts: (1) management's discussion and analysis, (2) the basic financial statements, (3) required supplementary information, and (4) statistical data, unaudited. The financial statements include notes that explain information in the statements by providing detailed data. These statements are followed by a section of required supplementary information that further explains and supports the financial statements, utilizing a comparison to the district's budget for the year. Additionally, the basic financial statements also include two kinds of statements that present different views of the district.

District-wide Financial Statements

The District-wide financial statements are full accrual basis statements that provide information about the district's **overall** financial status. They are used to help determine whether or not the District is better off, or worse off, as the result of the year's activities. The **Statement of Net Assets** reports all of the district's assets and liabilities, both short-term and long-term, whether they are "currently available" or not. Capital assets and long-term obligations of the district are reported in this statement. All of the current year's revenues and expenses are accounted for in the **Statement of Activities**, regardless of when cash is received or paid.

**Muskegon Heights Public Schools
Management's Discussion and Analysis
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The two district-wide statements report the district's *net assets* and how they have changed. A net asset – the difference between the district's assets and liabilities – is one way to measure the district's financial position.

- Over time, increases or decreases in net assets are an indicator of whether the district's financial position is improving or deteriorating.
- To assess the district's overall health, you need to consider additional non-financial factors such as changes in the district's property tax base, the quality of the education provided, and the condition of the district's buildings.

In district-wide statements, the district's activities are classified as *governmental activities*. This includes most of the District's basic services, such as regular and special education, food service, athletics, transportation, and administration. Property taxes, state aid, and state and federal grants finance most of these services.

Fund Financial Statements

The fund financial statements focus on individual parts of the district, while reporting the district's operations in more detail than the district-wide statements. The fund level statements are reported on a *modified accrual basis*. Only those assets that are "*measurable*" and "*currently available*" are reported. Liabilities are recognized to the extent that they are paid with current financial resources.

Fund statements are formatted to comply with the legal requirements of the Michigan Department of Education's "Accounting Manual." In the State of Michigan, the district's major instructional and instructional support activities are reported in the *General Fund*. Additional activities are reported in their relevant funds including: *Food Service*, *Athletics*, *Debt Service*, *Capital Projects*, and *Fiduciary Funds*.

In fund financial statements, capital asset purchases are reported as expenditures in the year of acquisition. No asset is reported. The issuance of debt is recorded as a financial resource. The current year's payments of principal and interest on long-term obligations are recorded as expenditures. Future year's debt obligations are not recorded.

**Muskegon Heights Public Schools
Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2006**

Financial Analysis of the District as a Whole

The net assets of the district at June 30, 2006 amounted to \$1.7 million. Figure A-1 shows a condensed breakdown of the net assets.

Figure A-1 Condensed Statement of Net Assets		
	Governmental Activities	
	<u>June 30, 2006</u>	<u>June 30, 2005</u>
Current Assets	\$ 7,449,725	\$ 9,343,593
Capital Assets, net	26,913,274	27,108,707
Other Non Current Assets	1,036,997	941,715
Total Assets	<u>35,399,996</u>	<u>37,394,015</u>
Current Liabilities	7,698,510	7,905,455
Non Current Liabilities	25,989,856	26,388,165
Total Liabilities	<u>33,688,366</u>	<u>34,293,620</u>
Net Assets		
Invested in Capital Assets, net of related debt	4,856,402	5,160,527
Restricted for:		
Debt Service	310,196	465,374
Unrestricted	<u>(3,454,968)</u>	<u>(2,525,506)</u>
Total Net Assets	<u>\$ 1,711,630</u>	<u>\$ 3,100,395</u>

The largest portion of the District's net assets reflects investment in capital assets (e.g., land, buildings and improvements, and furniture and equipment), less any related debt used to acquire those assets that are still outstanding. The District uses these capital assets to provide services to students; consequently, these assets are not available for future spending. Although the District's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay the debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

**Muskegon Heights Public Schools
Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2006**

The net assets of the District decreased by \$1.4 million during the 2005/06 year. Figure A-2 shows the breakdown of this change. The Statement of Activities presented later in the government-wide financial statements, provides greater detail on the District's annual activity. The cost of the District's governmental activities for the year was \$30 million.

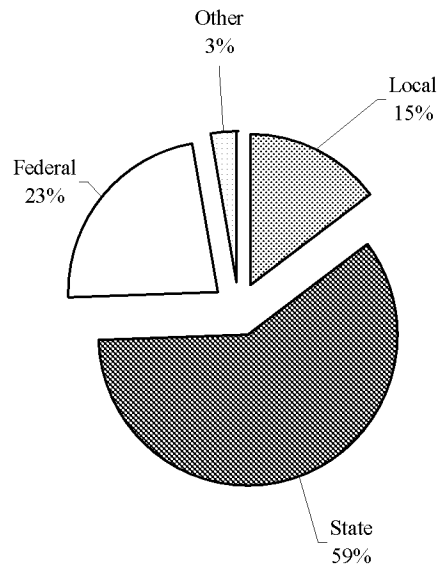
Charges for services include amounts received for Special Education transportation and other receipts from those who benefited from the food service, athletic and community service programs. Operating grants and contributions of \$10.4 million were for programs paid for by other governments and organizations. The other resources were provided from property taxes, state pupil foundation allowance (state aid), investment earnings and other miscellaneous services.

Figure A-2		
Statement of Net Assets from Operating Results		
	Governmental Activities	
For the Period Ending: June 30,	2006	2005
Revenues		
Program Revenues		
Charges for Services	\$ 819,320	\$ 822,189
Operating Grants and contributions	10,991,187	9,741,908
General Revenues		
Property taxes	3,207,475	3,076,693
Unrestricted grants and contributions	13,390,690	13,887,555
Other	156,084	72,876
Total revenues	28,564,756	27,601,221
Expenses		
Instruction	14,087,862	13,553,065
Support services	10,961,158	9,766,513
Community services	1,158,930	1,093,674
Food services	1,298,859	1,205,465
Athletics	333,391	307,013
Interest on long-term debt	950,541	1,271,510
Total expenses	28,790,741	27,197,240
Other changes		
Depreciation and interdistrict transfers	(1,162,780)	(1,091,898)
Increase (decrease) in net assets	(1,388,765)	(687,917)
Beginning net assets	3,100,395	3,788,312
Ending net assets	\$ 1,711,630	\$ 3,100,395

**Muskegon Heights Public Schools
Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2006**

A substantial portion (59%) of the District's revenue is received from State sources. This means that the financial stability of the District rests primarily with the economic health of the State of Michigan. Figure A-3 depicts the breakdown of the sources of revenue for the District.

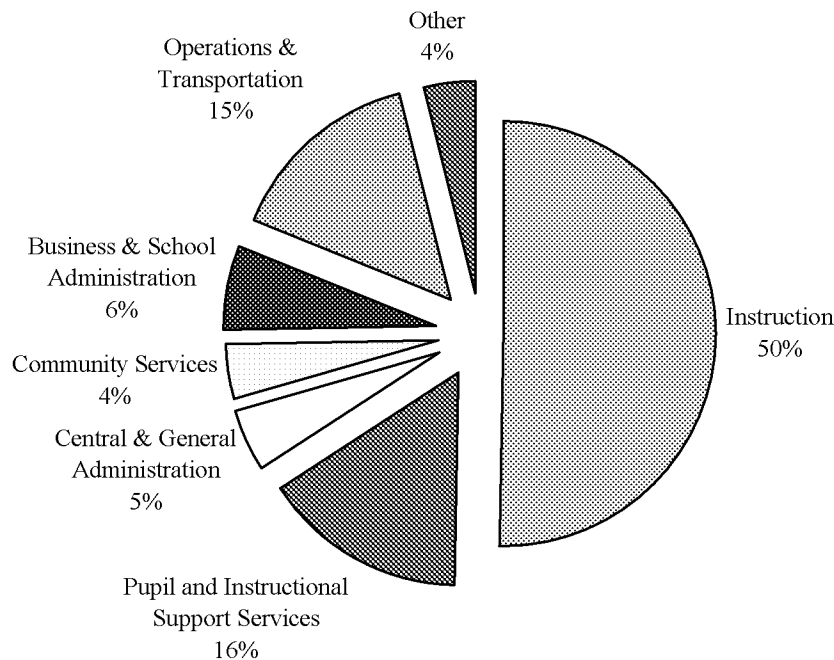
**Figure A-3
Sources of Revenues for Fiscal Year 2005/06**



**Muskegon Heights Public Schools
Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2006**

As Figure A-4 depicts, 66% of the District's resources are spent on instruction and pupil support services. Another 6% is spent on administrative and business services necessary to efficiently operate the District, while 15% is spent for building operation and maintenance, including utilities, custodial services and transportation. The final 13% is spent on interest and other support services.

**Figure A-4
Expenditures for Fiscal Year 2005/06**



**Muskegon Heights Public Schools
Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2006**

Financial Analysis of the District's Funds

The financial performance of the district as a whole is reflected in its governmental funds as well. The General Fund fund balance decreased by \$1,376,646 during the 2005/06 fiscal year, resulting in fund deficit of \$900,405 at year-end. The primary operational reasons for the fund deficit are as follows:

Factors Impacting Operations

Health Insurance premium increases – Four unions were covered under MESSA insurance: Teachers, Clerical, Administrators and Custodial Maintenance & Transportation. The District's cost for MESSA insurance premiums increased over the previous year by 7%. During the previous year 2004/05, the District was able to negotiate with various employee groups to switch to new insurance carriers to help reduce future costs. Those changes during 2005/06 are as follows: Two employee groups were covered under Priority Health (Head Start and Non-Union), and the Aides Union was covered under Michigan Employee Benefit Services. The insurance premium increases for Priority Health and Michigan Employee Benefit Services were 1.25% and 1.02%, respectively. For the next year 2006/07, two additional employee groups negotiated to change to Priority Health (Administrators and Custodial Maintenance & Transportation). The Teachers and Clerical unions remain the only groups covered by MESSA.

Retirement rate increase – The State of Michigan increased the retirement rate by 1.47% of all payroll expenditures.

Recovery recognition – During the fiscal year the district recognized \$202,351 in revenue due to GASB 33 revenue recognition rules.

General Fund Budgetary Highlights

The Uniform Budget Act of the State of Michigan requires that the local Board of Education approve the original budget for the upcoming fiscal year prior to July 1, the start of the fiscal year. As a matter of practice, the District amends its budget quarterly during the school year. These revisions are made in order to deal with unexpected changes in revenues and expenditures. The following analysis describes the reasons for changes in the budget during the year.

Revenues – There was a \$888,000 (3.4%) increase in the total General Fund revenue budget from the beginning to the end of the year. The changes in funding sources are as follows:

- The **local source** revenue budget increased by \$286,000. The increase was due to an increase in the collections of delinquent property taxes.
- The **state source** revenue budget decreased by \$1,180,000. The decrease was due to a reduction in student enrollment.

**Muskegon Heights Public Schools
Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2006**

- The ***federal source*** revenue budget increased by \$1,784,000, due in part to the inclusion of the Title I Carryover funds available from the 2004/05 fiscal year of \$268,000 and an increase in Title I funding of \$280,000. New grants awarded during the year included Title I School Improvement of \$195,000 and Title II-A of \$345,000.

Expenditures – The budgetary changes by functional category are as follows:

- The budget for ***instructional services*** increased by \$983,000 due to moving Literacy Coaches from supporting services into elementary instruction. Other increases were due to increased tuition expense for expelled students, yearbook, textbooks and band instruments. The services for preschool and summer school also increased.
- The budget for ***support services*** had a net increase of \$1.2 million. This increase was caused by additional Title I funding and two new grants for Title I School Improvement and Title II-A. Also, the professional and curriculum development activities to meet No Child Left Behind legislation, which were implemented in prior years, were continued through the current year. The District also incurred higher than expected expenses for building repairs and maintenance and a significant increase in heating fuel and electricity.
- The District sustained substantial employee benefit cost increases.

Amended Budget v. Actual Results

- The ***local source*** revenues increased due to a portion of property taxes being reclassified between operations and debt and a gross up of contributions for the Universal Service Fund 90% match of computer network upgrades.
- The ***state source*** revenues decreased due to deferring At-Risk funding not fully expended.
- The ***federal source*** revenues decreased due to the Title I, Title II-A and Title I School Improvement grants not being fully expended by year-end.
- Corresponding to the reduction in federal grant revenue was a reduction in federal grant expenditures in the areas of Added Needs, Instructional Staff and Central.
- Instructional staff was over budget due to the gross up of the computer network upgrades for the portion paid by the Universal Service Fund.
- Operations and Maintenance was over budget due to actual expenses being higher than anticipated for utilities, specifically heating and electricity.

**Muskegon Heights Public Schools
Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2006**

Capital Assets and Debt Administration

Capital Assets – A summary of the District's capital assets netted with accumulated depreciation at year-end is outlined as follows:

	<u>2006</u>	<u>2005</u>
Land	\$ 1,475,734	\$ 1,475,734
Construction in progress	167,187	52,225
Land Improvements	167,584	174,784
Buildings and Improvements	23,400,955	24,178,131
Equipment	1,594,361	1,122,318
Vehicles	107,453	105,515
Total	\$ <u>26,913,274</u>	\$ <u>27,108,707</u>

Debt Administration – A summary of the District's indebtedness is outlined below.

	<u>2006</u>	<u>2005</u>
1999 Building General Obligation Bonds	\$ 1,760,000	\$ 23,400,000
2006 Building General Obligation Bonds	21,272,361	0
Durant Bond Obligations	491,742	532,053
School Bond Loan Fund	2,556,947	2,456,634
Early Retirement Incentives and Compensated Absences	339,261	337,232
Capital Leases and other	<u>227,844</u>	<u>255,385</u>
Total	\$ <u>26,648,155</u>	\$ <u>26,981,304</u>

In February of 2006, the District refunded its 1999 School Building and Site Bonds at a lower interest rate in order to reduce its debt service payments over the next 23 years by over \$1.1 million.

Under State statute, the District is legally restricted from incurring long-term bonded debt in excess of 15% of the assessed value of taxable property within the school district. At June 30, 2005 the District's net bonded debt of \$491,712 was well below the legal limit of approximately \$17.8 million.

**Muskegon Heights Public Schools
Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2006**

**Currently Known Facts, Decisions, and Conditions
Affecting the 2006/2007 Fiscal Year**

The State of Michigan currently begins their State Aid payment cycle in mid-October, which creates a window of time in which no cash is coming in, thus causing the District to borrow \$2,700,000 in August 2006, which will mature August 2007.

Due to declining enrollment, the District consolidated one elementary building. Elementary students moved into the other four elementary buildings, and the Adult Ed and Alternative Ed programs were brought back into a District-owned building. This will result in cost savings for rent, utilities and maintenance of a rental space.

The District reduced 22 teacher positions in October 2006. The business office staff was also reduced by one position.

The District cut back on non-essential transportation.

The Administrators and Custodial Maintenance & Transportation unions changed health insurance carriers from MESSA to Priority Health, thus reducing future costs.

The District has been awarded a three-year Reading First grant that commenced in 2005/06. This grant will bring over \$1.5 million into the District for Professional Development and intensive reading activities for children.

Requests for Information

This financial report is designed to provide the district's citizens, taxpayers, parents, students, investors and creditors with a general overview of the District's finances, and to show how the District is accountable for the money it receives. Questions concerning any of the information provided in this report, or requests for additional financial information should be addressed to Mr. Dana M. Bryant, Superintendent, Muskegon Heights Public Schools, 2603 Leahy Street, Muskegon Heights, MI 49444, telephone number (231) 830-3220.

BRICKLEY DELONG

CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

October 27, 2006

Board of Education
School District of the City of Muskegon Heights
Muskegon Heights, Michigan

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the School District of the City of Muskegon Heights (the School District), as of and for the year ended June 30, 2006, which collectively comprise the Schools District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the School District of the City of Muskegon Heights' management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the School District of the City of Muskegon Heights, as of June 30, 2006, and the respective changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards* we have also issued our report dated October 27, 2006, on our consideration of the School District of the City of Muskegon Heights' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the result of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

BRICKLEY DELONG

Board of Education
October 27, 2006
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The management's discussion and analysis and budgetary comparison information on pages i - x and page 28, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

The statistical data included on pages 30 - 38 has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we express no opinion on it.

Brickley DeLong, PLC

School District of the City of Muskegon Heights
STATEMENT OF NET ASSETS
June 30, 2006

	ASSETS	Governmental activities
CURRENT ASSETS		
Cash and cash equivalents		\$ 2,240,542
Receivables		658,699
Due from other governmental units		4,540,583
Inventories		<u>9,901</u>
Total current assets		7,449,725
NONCURRENT ASSETS		
Capital assets, net		
Nondepreciable		1,642,921
Depreciable		25,270,353
Bond issuance costs, net		492,386
Note and interest receivable		<u>544,611</u>
Total noncurrent assets		<u>27,950,271</u>
Total assets		35,399,996
	LIABILITIES AND NET ASSETS	
CURRENT LIABILITIES		
State aid loan		2,600,000
Accounts payable and accrued liabilities		3,241,395
Due to other governmental units		805,327
Deferred revenue		340,620
Bonds and other obligations, due within one year		<u>711,168</u>
Total current liabilities		7,698,510
NONCURRENT LIABILITIES		
Bonds and other obligations, less amounts due within one year		25,936,987
Accrued interest		<u>52,869</u>
Total noncurrent liabilities		<u>25,989,856</u>
Total liabilities		<u>33,688,366</u>
NET ASSETS		
Invested in capital assets, net of related debt		4,856,402
Restricted for debt service		310,196
Unrestricted		<u>(3,454,968)</u>
Total net assets		<u>\$ 1,711,630</u>

The accompanying notes are an integral part of this statement.

School District of the City of Muskegon Heights
STATEMENT OF ACTIVITIES
For the year ended June 30, 2006

Functions/Programs	<u>Expenses</u>	<u>Program Revenue</u>		Net (Expense)
		<u>Charges for</u>	<u>Operating grants</u>	Revenue and
		<u>services</u>	<u>and contributions</u>	Changes in
				Net Assets
				<u>Governmental</u>
				<u>activities</u>
Governmental activities				
Instruction	\$ 14,087,862	\$ 12,699	\$ 3,976,257	\$ (10,098,906)
Support services	10,961,158	607,864	4,716,986	(5,636,308)
Community services	1,158,930	-	1,110,722	(48,208)
Food services	1,298,859	122,985	1,169,290	(6,584)
Athletics	333,391	75,772	-	(257,619)
Interest on long-term debt	950,541	-	17,932	(932,609)
Unallocated depreciation and amortization	1,162,780	-	-	(1,162,780)
Total governmental activities	<u>\$ 29,953,521</u>	<u>\$ 819,320</u>	<u>\$ 10,991,187</u>	(18,143,014)
General revenues				
Property taxes levied for				
General purposes				1,670,616
Debt service				1,536,859
Grants and contributions not restricted to specific programs				13,390,690
Investment earnings				95,348
Miscellaneous				60,736
Total general revenues				<u>16,754,249</u>
Change in net assets				(1,388,765)
Net assets at July 1, 2005				<u>3,100,395</u>
Net assets at June 30, 2006				<u>\$ 1,711,630</u>

The accompanying notes are an integral part of this statement.

School District of the City of Muskegon Heights

BALANCE SHEET

Governmental Funds

June 30, 2006

	General Fund	1999 Building Capital Projects Fund	Other governmental funds	Total governmental funds
ASSETS				
Cash and cash equivalents	\$ 739,448	\$ 1,173,474	\$ 327,620	\$ 2,240,542
Receivables	609,111	-	33,336	642,447
Due from other governmental units	4,385,054	-	155,529	4,540,583
Due from other funds	336,235	30,537	183,580	550,352
Inventories	52	-	9,849	9,901
Total assets	<u>\$ 6,069,900</u>	<u>\$ 1,204,011</u>	<u>\$ 709,914</u>	<u>\$ 7,983,825</u>
LIABILITIES AND FUND BALANCES (DEFICIT)				
Liabilities				
State aid loan	\$ 2,600,000	\$ -	\$ -	\$ 2,600,000
Accounts payable	328,205	1,322	171,768	501,295
Accrued liabilities	2,532,024	-	20,255	2,552,279
Due to other governmental units	805,327	-	-	805,327
Due to other funds	214,117	-	336,235	550,352
Deferred revenue	490,632	-	-	490,632
Total liabilities	<u>6,970,305</u>	<u>1,322</u>	<u>528,258</u>	<u>7,499,885</u>
Fund balances (deficit)				
Reserved				
Inventories	52	-	9,849	9,901
Debt service	-	-	544,398	544,398
Capital projects	-	1,202,689	-	1,202,689
Unreserved				
Designated for scholarships	72,923	-	-	72,923
Undesignated				
General Fund	(973,380)	-	-	(973,380)
School service	-	-	(372,591)	(372,591)
Total fund balances (deficit)	<u>(900,405)</u>	<u>1,202,689</u>	<u>181,656</u>	<u>483,940</u>
Total liabilities and fund balances	<u>\$ 6,069,900</u>	<u>\$ 1,204,011</u>	<u>\$ 709,914</u>	<u>\$ 7,983,825</u>

The accompanying notes are an integral part of this statement.

School District of the City of Muskegon Heights
**RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
 TO THE STATEMENT OF NET ASSETS**
 June 30, 2006

Total fund balance—governmental funds	\$	483,940
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Amounts reported for governmental activities in the Statement of Net Assets
are different because:

Capital assets used in governmental activities are not current financial resources and
are not reported in the governmental funds.

Cost of capital assets	\$ 38,871,737	
Accumulated depreciation	<u>(11,958,463)</u>	26,913,274

Bond issuance costs are not capitalized and amortized in the governmental funds.

Bond issuance costs	666,430	
Accumulated amortization	<u>(174,044)</u>	492,386

Other long-term note and interest receivable in governmental activities is not reported in the
governmental funds.

560,863

Accrued interest in governmental activities is not reported in the governmental funds.

(240,690)

Deferred revenue reported on the balance sheet that does not provide current financial
resources is not reported as revenue in the governmental funds.

150,012

Long-term liabilities in governmental activities are not due and payable in the current period
and are not reported in the governmental funds.

Bonds and notes payable	(26,308,894)	
Compensated absences	(180,261)	
Early retirement incentives	<u>(159,000)</u>	<u>(26,648,155)</u>

Net assets of governmental activities in the Statement of Net Assets

\$ 1,711,630

The accompanying notes are an integral part of this statement.

School District of the City of Muskegon Heights
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
Governmental Funds
For the year ended June 30, 2006

	General Fund	1999 Building Capital Projects Fund	Other governmental funds	Total governmental funds
REVENUES				
Local sources				
Property taxes	\$ 1,670,616	\$ -	\$ 1,536,859	\$ 3,207,475
Investment earnings	45,635	37,792	11,921	95,348
Fees and charges	605,408	-	198,757	804,165
Other	<u>769,506</u>	<u>-</u>	<u>-</u>	<u>769,506</u>
Total local sources	3,091,165	37,792	1,747,537	4,876,494
State sources	16,733,578	-	140,835	16,874,413
Federal sources	<u>5,301,919</u>	<u>-</u>	<u>1,086,937</u>	<u>6,388,856</u>
Total revenues	25,126,662	37,792	2,975,309	28,139,763
EXPENDITURES				
Instruction	13,694,309	-	-	13,694,309
Support services	11,277,373	-	-	11,277,373
Community services	1,158,930	-	-	1,158,930
Food services	-	-	1,306,114	1,306,114
Athletics	-	-	333,391	333,391
Debt service				
Principal	-	-	565,311	565,311
Interest and other charges	-	-	866,791	866,791
Advance refunding escrow	-	-	100,000	100,000
Bond issuance cost	-	-	241,054	241,054
Capital projects	<u>-</u>	<u>202,006</u>	<u>-</u>	<u>202,006</u>
Total expenditures	26,130,612	202,006	3,412,661	29,745,279
Excess (deficiency) of revenues over (under) expenditures	(1,003,950)	(164,214)	(437,352)	(1,605,516)
OTHER FINANCING SOURCES (USES)				
Transfers from other governmental units and other transactions	667,894	-	-	667,894
Loan proceeds	30,376	-	-	30,376
Proceeds of refunding bonds	-	-	22,030,000	22,030,000
Discount on issuance of bonds	-	-	(124,591)	(124,591)
Transfers in	-	-	501,582	501,582
Transfers out	(275,000)	-	(226,582)	(501,582)
Payment to refunded bond escrow agent	-	-	(21,660,491)	(21,660,491)
Transfers to other governmental units and other transactions	<u>(795,966)</u>	<u>-</u>	<u>-</u>	<u>(795,966)</u>
Total other financing sources (uses)	(372,696)	-	519,918	147,222
Net change in fund balances	(1,376,646)	(164,214)	82,566	(1,458,294)
Fund balances at July 1, 2005	<u>476,241</u>	<u>1,366,903</u>	<u>99,090</u>	<u>1,942,234</u>
Fund balances (deficit) at June 30, 2006	<u>\$ (900,405)</u>	<u>\$ 1,202,689</u>	<u>\$ 181,656</u>	<u>\$ 483,940</u>

The accompanying notes are an integral part of this statement.

School District of the City of Muskegon Heights
**RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES TO THE STATEMENT OF ACTIVITIES**
For the year ended June 30, 2006

Net change in fund balances—total governmental funds \$ (1,458,294)

Amounts reported for governmental activities in the Statement of Activities are different because:

Governmental funds report outlays for capital assets and bond issuance costs as expenditures; in the Statement of Activities these costs are depreciated and amortized over their estimated useful lives, respectively.

Depreciation and amortization expense	\$ (1,162,780)	
Capital outlay and bond issuance costs	<u>1,119,431</u>	(43,349)

Receipt of principal on note receivable is a revenue in the governmental funds, but the receipt reduces noncurrent assets in the Statement of Activities	(40,311)
--	----------

Interest income on long-term note receivable is recorded in the Statement of Activities when earned, but is not reported in governmental funds until received.	(239)
--	-------

Revenue reported in the Statement of Activities that does not provide current financial resources are not reported as revenue in the governmental funds.	(202,351)
--	-----------

Debt proceeds are other financing sources in the governmental funds, but the proceeds increase long-term debt in the Statement of Net Assets.	(21,390,607)
---	--------------

Repayment of principal on long-term debt is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the Statement of Net Assets.	21,725,785
---	------------

Interest expense on long-term debt is recorded in the Statement of Activities when incurred, but is not reported in the governmental funds until paid.	22,630
--	--------

Compensated absences and early retirement incentives are reported on the accrual method in the Statement of Activities and reported as expenditures when financial resources are used in the governmental funds.	<u>(2,029)</u>
--	----------------

Change in net assets of governmental activities	<u><u>\$ (1,388,765)</u></u>
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The accompanying notes are an integral part of this statement.

School District of the City of Muskegon Heights
STATEMENT OF FIDUCIARY ASSETS AND LIABILITIES
Fiduciary Funds
June 30, 2006

	Agency funds
ASSETS	
Cash and cash equivalents	\$ 52,925
LIABILITIES	
Deposits held for others	\$ 52,925

The accompanying notes are an integral part of this statement.

School District of the City of Muskegon Heights

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the School District of the City of Muskegon Heights (School District) have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the School District's accounting policies are described below.

Reporting Entity

The School District is governed by an elected seven-member Board of Education (Board), which has responsibility and control over all activities related to public school education within the School District. The School District receives funding from local, state, and federal government sources and must comply with all of the requirements of these funding source entities. However, the School District is not included in any other governmental reporting entity as defined by generally accepted accounting principles. In addition, the School District's reporting entity does not contain any component units as defined in Governmental Accounting Standards Board Statement No. 14. Board members have decision-making authority, the power to designate management, the ability to significantly influence operations, and the primary accountability for fiscal matters.

District-wide and Fund Financial Statements

District-wide Financial Statements – The primary focus of district-wide financial statements is on the sustainability of the School District as an entity and the change in the School District's net assets resulting from the current year's activities. The district-wide financial statements (i.e., the Statement of Net Assets and the Statement of Activities) report information on all of the non-fiduciary activities of the School District. For the most part, the effect of interfund activity has been removed from these statements. The district-wide financial statements categorize primary activities as either governmental or business type. All of the School District's activities are classified as governmental activities.

In the district-wide Statement of Net Assets, the governmental activities column (a) is presented on a consolidated basis and (b) is reported on a full accrual, economic resource basis, which recognizes all long-term assets and receivables as well as long-term debt and obligations. The School District's net assets are reported in three parts – invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets.

The Statement of Activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. The School District first utilizes restricted resources to finance qualifying activities. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include 1) charges paid by recipients who purchase, use or directly benefit from goods or services by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. State Foundation Aid, certain revenue from the intermediate school district, and other unrestricted items are not included as program revenues but instead as *general revenues*.

The district-wide Statement of Activities reports both the gross and net cost of each of the School District's functions. The functions are also supported by general revenues (property taxes, certain intergovernmental revenues and charges, etc.). The Statement of Activities reduces gross expenses by related program revenues and operating grants. Program revenues must be directly associated with the function. Operating grants include operating-specific and discretionary (either operating or capital) grants. The School District does not allocate indirect costs.

School District of the City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

District-wide and Fund Financial Statements—Continued

Fund financial statements – Fund financial statements are provided for governmental funds and fiduciary funds, even though the latter are excluded from district-wide financial statements. Major individual governmental funds are reported as separate columns in the fund financial statements.

Governmental funds – Governmental funds are those funds through which most School District functions typically are financed. The acquisition, use and balances of the School District's expendable financial resources and the related current liabilities are accounted for through governmental funds.

The School District reports the following major governmental funds:

- The *General Fund* is the School District's primary operating fund. It accounts for all financial resources of the School District, except those required to be accounted for in another fund.
- The *1999 Building Capital Projects Fund* accounts for the use of the proceeds from the 1999 School Building and Site Bonds. The Bonds were approved for issuance on March 9, 1999 and may be used for school building and site purposes.

The other nonmajor governmental funds are reported within the following types:

- The *special revenue funds* account for revenue sources that are legally restricted to expenditures for specific purposes (not including expendable trusts or major capital projects). The School District accounts for its food service and athletic activities in the school service special revenue funds.
- The *debt service funds* account for the resources accumulated and payments made for principal and interest on long-term general obligation debt of governmental funds.

Fiduciary funds – Fiduciary funds account for assets held by the School District in a trustee capacity or as an agent on behalf of others. Trust funds account for assets held by the School District under the terms of a formal trust agreement. Fiduciary funds are not included in the district-wide statements.

- The *agency fund* is custodial in nature and does not present results of operations or have a measurement focus. Agency funds are accounted for using the modified accrual basis of accounting. This fund is used to account for assets that the School District holds for others in an agency capacity (primarily student activities).

Measurement Focus, Basis of Accounting and Basis of Presentation

Accrual Method

The district-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting* as are the fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants, categorical aids and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

School District of the City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED

June 30, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Measurement Focus, Basis of Accounting and Basis of Presentation—Continued

Modified Accrual Method

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. With this measurement focus, operating statements present increases and decreases in net current assets, and unreserved fund balance is a measure of available spendable resources. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the School District considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, unrestricted state aid, intergovernmental grants, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the School District.

State Revenue

The State of Michigan utilizes a foundation grant approach which provides for a specific annual amount of revenue per pupil based on a statewide formula. The Foundation is funded from state and local sources. Revenues from state sources are primarily governed by the School Aid Act and the School Code of Michigan. The Michigan Department of Education administers the allocation of state funds to school districts based on information supplied by the school districts. For the year ended June 30, 2006, the foundation allowance was based on pupil membership counts taken in February and September of 2005.

The state portion of the foundation is provided primarily by a state education property tax millage of 6 mills and an allocated portion of state sales and other taxes. The local portion of the foundation is funded primarily by non-homestead property taxes which may be levied at a rate of up to 18 mills. The state revenue is recognized during the foundation period and is funded through payments from October 2005 to August 2006. Thus, the unpaid portion at June 30, 2006 is reported as due from other governmental units.

The School District also receives revenue from the state to administer certain categorical education programs. State rules require that revenue earmarked for these programs be used for its specific purpose. Certain governmental funds require an accounting to the state of the expenditures incurred. For categorical funds meeting this requirement, funds received, which are not expended by the close of the fiscal year are recorded as deferred revenue. Other categorical funding is recognized when the appropriation is received.

School District of the City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED

June 30, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Other Accounting Policies

Deposit and Investments

Cash and cash equivalents include cash on hand, demand deposits and short-term investments with a maturity of three months or less when acquired. Investments are stated at fair value.

The School District reports its investments in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Under this standard, certain investments are valued at fair value as determined by quoted market prices or by estimated fair values when quoted market prices are not available. The standard also provides that certain investments are valued at cost (or amortized cost) when they are of a short-term duration, the rate of return is fixed, and the School District intends to hold the investment until maturity.

State statutes authorize the School District to invest in bonds and other direct and certain indirect obligations of the U.S. Treasury; certificates of deposit, savings accounts, deposit accounts, or depository receipts of a bank, savings and loan association, or credit union, which is a member of the Federal Deposit Insurance Corporation, Federal Savings and Loan Insurance Corporation, or National Credit Union Administration, respectively; in commercial paper rated at the time of purchase within the three highest classifications established by not less than two standard rating services and which matures not more than 270 days after the date of purchase. The School District is also authorized to invest in U. S. Government or federal agency obligation repurchase agreements, bankers' acceptances of U.S. banks, and mutual funds composed of investments as outlined above. The School District's deposits and investments are in accordance with statutory authority.

Interfund Receivables and Payables

Activities between funds that are representative of lending or borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds". The School District had no advances between funds.

Property Taxes

Property taxes levied by the School District are collected by various municipalities and periodically remitted to the School District. The taxes are levied as of July 1 and December 1 and are due upon receipt of the billing by the taxpayer and become a lien on the first day of the levy year. The actual due dates are September 14 and February 14, after which time the bills become delinquent and penalties and interest may be assessed by the collecting entity.

For the year ended June 30, 2006, the School District levied the following amounts per \$1,000 of taxable valuation:

<u>Fund</u>	<u>Mills</u>
General Fund - Non-homestead	18.0
Debt service funds - Homestead and non-homestead	12.5

Inventories

Food service inventory is valued at the lower of cost (first-in, first-out) or market. The inventory is expendable supplies held for consumption and is recorded as expenditures when consumed rather than when purchased. Inventories for commodities are recorded as revenue when utilized.

School District of the City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Other Accounting Policies—Continued

Prepaid Items

Payments made to vendors for services that will benefit periods beyond the fiscal year end are recorded as prepaid items using the consumption method. A current asset for the prepaid amount is recorded at the time of the purchase and an expenditure/expense is reported in the year in which services are consumed.

Restricted Assets

Assets are reported as restricted when limitations on their use change the normal understanding of the availability of the asset. Such constraints are either imposed by creditors, contributors, grantors, or laws of other governments or imposed by enabling legislation. Restricted assets include bond proceeds to be used for capital construction.

Capital Assets

Capital assets purchased or acquired are capitalized at historical cost or estimated historical cost. Donated fixed assets are valued at their estimated fair market value on the date received. Capital assets are defined by the School District as assets with an initial cost of more than \$5,000 and an estimated useful life in excess of one year. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Improvements are capitalized and depreciated over the remaining useful lives of the related fixed assets. The School District does not have infrastructure-type assets.

Depreciation is provided on the straight-line basis over the following useful lives:

Buildings and improvements	30-40 years
Buses and other vehicles	10 years
Furniture and other equipment	5-10 years

Land and certain land improvements are deemed to be inexhaustible capital assets, as the economic benefit or service potential is used up so slowly that the estimated useful life is extraordinarily long. These inexhaustible assets are not depreciated.

Compensated Absences

The liability for compensated absences reported in the district-wide statement consists of unpaid, accumulated sick leave balances. The liability has been calculated using the vesting method, in which leave amounts for both employees who are currently eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included.

For fund financial statements, no compensated absence liability is reported for current employees and a compensated absence liability is reported for terminated employees only when the termination date is on or before year end.

Early Retirement Incentives

For district-wide financial statements, the liability for early retirement incentives is reported when legally enforceable. For fund financial statements, the liability for early retirement incentives is reported either 1) on the due date when there is a specified due date or 2) on the retirement date if it is before year end, when there is not a specified legally enforceable due date.

School District of the City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED

June 30, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Other Accounting Policies—Continued

Long-term Obligations

In the district-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the Statement of Net Assets. Bond premiums and discounts, as well as issuance cost, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

Net Assets In District-wide Financial Statements

Net assets represent the difference between assets and liabilities and are segregated into the following components:

- **Invested in capital assets, net of related debt** consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.
- **Restricted net assets** result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributions, and the like, or imposed by law through constitutional provisions or enabling legislation.
- **Unrestricted net assets** consist of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources which are imposed by management, but can be removed or modified.

Fund Equity In Fund Financial Statements

The School District reserves those portions of governmental fund balances that are legally segregated for specific future use or which do not represent available expendable resources and therefore are not available for appropriations for expenditures. Unreserved fund balance indicates that portion of fund equity which is available for appropriation in future periods. Fund balance reserves are established for encumbrances, inventory of materials and supplies, prepaid items, deferred charges and advances to other funds, when applicable. Designations of fund balance represent tentative management plans that are subject to change.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statement and accompanying notes. Actual results may differ from those estimates.

School District of the City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED

June 30, 2006

NOTE B—STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Budgets and Budgetary Accounting

Budgets are adopted on a basis consistent with accounting principles generally accepted in the United States of America. Annual appropriated budgets are adopted for the General Fund and special revenue funds. All annual appropriations lapse at year end.

The School District follows these procedures in establishing the budgetary data reflected in the financial statements:

1. The Superintendent submits to the School Board a proposed operating budget for the fiscal year commencing on July 1. The operating budget includes proposed expenditures and the means of financing them. The level of control for the budgets is at the functional level as set forth and presented as required supplementary information.
2. Public hearings are conducted to obtain taxpayer comments.
3. Prior to July 1, the budget is legally adopted by Board of Education resolution pursuant to the Uniform Budgeting and Accounting Act (P.A. 621 of 1978). The Act requires that the budget be amended prior to the end of the fiscal year when necessary to adjust appropriations if it appears that revenues and other financing sources will be less than anticipated or so that expenditures will not be in excess of original estimates. Expenditures shall not be made or incurred, unless authorized in the budget, in excess of the amount appropriated. Violations, if any, are noted in the required supplementary information section.
4. The Superintendent is authorized to transfer budgeted amounts within major expenditure functions within any fund; however, these transfers and any revisions that alter the total expenditures of any fund must be approved by the Board of Education.
5. Formal budgetary integration is employed as a management control device during the year.
6. The budget is amended during the year with supplemental appropriations, the last one approved prior to June 30, 2006. The School District does not consider these amendments to be significant.

Excess of Expenditures Over Appropriations

For the year ended June 30, 2006, expenditures exceeded appropriations in school administration, business, operations and maintenance, pupil transportation services and outgoing transfers functions by \$31,177, \$46,074, \$128,886, \$19,301 and \$43,276, respectively.

Fund Deficits

As of June 30, 2006, the General Fund had a deficit of \$900,405, the Athletic Fund had a deficit of \$57,877 and the Food Service Fund had a deficit of \$304,865. The deficits will be eliminated through future operations, which may include reduction of operating expenses and interfund transfers.

School District of the City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED

June 30, 2006

NOTE B—STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY—Continued

School Bond Construction Compliance

The capital projects fund includes capital project activities funded with bonds issued after May 1, 1994. For this capital project, the School District has complied with the applicable provisions of §1351(a) of the State of Michigan's School Code.

Following is a summary of the revenue and expenditures in the 1999 Building Capital Projects Fund from the inception of the fund through June 30, 2006.

	<u>1999 Building Capital Projects Fund</u>
Revenue and bond proceeds	\$ 29,561,414
Expenditures	28,358,725

NOTE C—DEPOSITS AND INVESTMENTS

As of June 30, 2006, the School District had the following investments:

Investment Type	<u>Fair value</u>	<u>Weighted average maturity (Days)</u>	<u>Standard & Poor's rating</u>	<u>Percent</u>
External investment pool	\$ <u>1,872,401</u>	21	A1	<u>100%</u>

The School District voluntarily invests certain excess funds in external investment pools (Pools). The Pools are external investment pools of "qualified" investments for Michigan school districts. The Pools are not regulated nor are they registered with the SEC. The fair value of the School District's investments is the same as the value of the Pool shares.

Interest rate risk. The School District does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit risk. State law limits investments in commercial paper and corporate bonds to the three highest classifications issued by nationally recognized statistical rating organizations. The School District has no investment policy that would further limit its investment choices.

Concentration of credit risk. The School District does not have a concentration of credit risk policy. Concentration of credit risk is the risk of loss attributed to the magnitude of the School District investment in a single issuer, by diversifying the investment portfolio so that the impact of potential losses from any one type of security or issuer will be minimized.

Custodial credit risk - deposits. In the case of deposits, this is the risk that in the event of a bank failure, the School District's deposits may not be returned to it. As of June 30, 2006, \$1,081,819 of the School District's bank balance of \$1,281,819 was exposed to custodial credit risk because it was uninsured and uncollateralized.

Custodial credit risk - investments. The School District does not have a custodial credit risk policy for investments. This is the risk that, in the event of the failure of the counterparty, the School District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party.

Foreign currency risk. The School District is not authorized to invest in investments which have this type of risk.

School District of the City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE D—CAPITAL ASSETS

	Balance July 1, 2005	Additions	Deductions	Balance June 30, 2006
Capital assets, not being depreciated:				
Land	\$ 1,475,734	\$ -	\$ -	\$ 1,475,734
Construction in progress	52,225	114,962	-	167,187
Total capital assets, not being depreciated	1,527,959	114,962	-	1,642,921
Capital assets, being depreciated:				
Land improvements	561,442	8,561	-	570,003
Buildings and improvements	33,536,268	-	-	33,536,268
Equipment	1,809,559	724,478	-	2,534,037
Vehicles	623,935	30,376	65,803	588,508
Total capital assets, being depreciated	36,531,204	763,415	65,803	37,228,816
Less accumulated depreciation:				
Land improvements	386,658	15,761	-	402,419
Buildings and improvements	9,358,137	777,176	-	10,135,313
Equipment	687,241	252,435	-	939,676
Vehicles	518,420	28,438	65,803	481,055
Total accumulated depreciation	10,950,456	1,073,810	65,803	11,958,463
Total capital assets, being depreciated, net	25,580,748	(310,395)	-	25,270,353
Capital assets, net	\$ 27,108,707	\$ (195,433)	\$ -	\$ 26,913,274

Depreciation

Depreciation expense has been charged as unallocated depreciation.

School District of the City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE E—BOND ISSUANCE COSTS

Bond issuance cost activity for the year ended June 30, 2006 was as follows:

	Balance July 1, 2005	Additions	Deductions	Balance June 30, 2006
Bond issuance costs	\$ 425,376	\$ 241,054	\$ -	\$ 666,430
Less accumulated amortization	<u>85,074</u>	<u>88,970</u>	<u>-</u>	<u>174,044</u>
Bond issuance costs, net	<u>\$ 340,302</u>	<u>\$ 152,084</u>	<u>\$ -</u>	<u>\$ 492,386</u>

Amortization

Amortization expense has been charged as unallocated amortization.

NOTE F—INTERFUND RECEIVABLES, PAYABLES AND TRANSFERS

The composition of interfund balances as of June 30, 2006 is as follows:

Due to/from other funds:

<u>Receivable fund</u>	<u>Payable fund</u>	<u>Amount</u>
General Fund	Other governmental funds	\$ 336,235
1999 Building Capital Projects Fund	General Fund	30,537
Other governmental funds	General Fund	<u>183,580</u>
		<u>\$ 550,352</u>

The outstanding balances between funds result mainly from the time lag between the dates that (1) interfund goods and services are provided or reimbursable expenditures occur, (2) transactions are recorded in the accounting system, and (3) payments between funds are made.

Interfund Transfers

The General Fund transferred \$250,000 to the Athletics Fund and \$25,000 to the Food Service Fund to finance operations. The 1999 Debt Retirement Fund transferred \$326,582 to the 2006 Debt Retirement Fund to finance the 2006 Refunding Bond expenditures.

School District of the City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE G—SHORT-TERM DEBT

The School District issues State of Michigan school aid anticipation notes to provide short-term operating funds. The notes are obligations of the General Fund, which received the note proceeds, and are backed by the full faith, credit and resources of the School District. The short-term debt activity for the year ended June 30, 2006 follows:

	<u>Balance</u> <u>July 1, 2005</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>June 30, 2006</u>
State aid anticipation note				
2004/2005 2.00% due July 2005	\$ 2,600,000	\$ -	\$ 2,600,000	\$ -
2005/2006 3.50% due July 2006	<u>-</u>	<u>2,600,000</u>	<u>-</u>	<u>2,600,000</u>
	<u>\$ 2,600,000</u>	<u>\$ 2,600,000</u>	<u>\$ 2,600,000</u>	<u>\$ 2,600,000</u>

NOTE H—DEFERRED REVENUE

Governmental funds report deferred revenue in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. Governmental funds also defer revenue recognition in connection with resources that have been received, but not yet earned. At the end of the current fiscal year, the various components of deferred revenue reported in the governmental funds were as follows:

	<u>Unavailable</u>	<u>Unearned</u>
Due from other governmental units	\$ 150,012	\$ -
State aid grant funds received prior to spending funds	-	228,620
TIF capture	<u>-</u>	<u>112,000</u>
Total deferred revenue for governmental funds	<u>\$ 150,012</u>	<u>\$ 340,620</u>

NOTE I—LONG-TERM OBLIGATIONS

The School District issues bonds, notes and other contractual commitments to provide for the acquisition, construction and improvement of major capital facilities and for the acquisition of certain equipment. General obligation bonds are direct obligations and pledge the full faith and credit of the School District. Other long-term obligations include School Bond Loan Fund, capital leases for office equipment, equipment loan payable and Education Interconnection and Consortium Financing Agreement.

Summary of Long-term Obligations

On February 15, 2006, the School District issued \$22.03 million in General Obligation Bonds with interest rates from 3.25 to 5 percent to partially advance refund \$21.115 million of outstanding 1999 School Building and Site Bonds with interest rates from 4.45 to 5 percent. The net proceeds of approximately \$21.8 million (after payment of \$245 thousand in underwriting fees, insurance and other issuance costs) including \$100 thousand of 1999 Debt Retirement fund monies were used to purchase U.S. government securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for principle redemption and interest of 1999 School Building and Site Bonds which are scheduled for maturity May 2010 and beyond. As a result, the 1999 School Building and Site Bonds are considered to be partially defeased and the liability for those bonds has been removed from long-term obligations.

School District of the City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE I—LONG-TERM OBLIGATIONS—Continued

Summary of Long-term Obligations—Continued

The School District advance refunded the 1999 School Building and Site Bonds to reduce its total debt service payments over the next 23 years by over \$1.1 million and to obtain an economic gain (difference between the present values of the debt service payments on the old and new debt) of over \$800 thousand.

The following is a summary of long-term obligations activity for the School District for the year ended June 30, 2006.

	Balance July 1, 2005	Additions	Reductions	Balance June 30, 2006	Due within one year
Governmental activities:					
Bonds	\$ 23,932,053	\$ 21,259,918	\$ 21,667,868	\$ 23,524,103	\$ 597,221
Other obligations	2,712,019	130,689	57,917	2,784,791	72,947
Early retirement incentives	173,000	23,000	37,000	159,000	41,000
Compensated absences	164,232	58,413	42,384	180,261	-
	<u>\$ 26,981,304</u>	<u>\$ 21,472,020</u>	<u>\$ 21,805,169</u>	<u>\$ 26,648,155</u>	<u>\$ 711,168</u>

In the previous schedule, the addition for other obligations of \$130,689 includes \$100,313 of accrued interest on the School Bond Loan Fund and \$30,376 for an equipment loan payable.

General obligation bonds consist of the following:

1999 Building General Obligation Bond

partially refunded February 2006; payable in annual installments ranging from \$555,000 to \$620,000 due May 2007 to 2009; plus interest of 5.50% payable semi-annually.

\$ 1,760,000

2006 General Obligation Refunding Bond

payable in annual installments ranging from \$50,000 to \$1,580,000 due May 2009 to 2029; plus interest ranging from 3.25% to 5% payable semi-annually.

22,030,000

Less issuance discount

(122,578)

Less deferred amount on refunding

(635,061)

Durant obligations payable in annual installments

ranging from \$58,473 to \$198,961 including interest at 4.76% due May 2007 to 2013.

The School District is only obligated to make the annual payments to the extent of annual State of Michigan state school aid appropriations.

491,742

Total bonded debt

23,524,103

School District of the City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE I—LONG-TERM OBLIGATIONS—Continued

Summary of Long-term Obligations—Continued

Other obligations

School Bond Loan Fund payable as soon as annual tax collections exceed annual debt service payment requirements; interest payable of \$402,104 is included at interest rates between 2.625% and 4.5%	\$ 2,556,947
Capital lease obligations payable in monthly installments of approximately \$5,880 including interest ranging from 4.04% to 9.58%; final payment due January 2010	166,729
Education Interconnection and Consortium Financing Agreement payable in annual installments of \$4,391 due March 2007 to 2013	30,739
Equipment loan payable in annual installments of \$10,125 through August 2008; plus interest at 6.04%	<u>30,376</u>
Total other obligations	2,784,791
Early retirement incentives	159,000
Compensated absences	<u>180,261</u>
	<u>\$ 26,648,155</u>

The Durant bonds, including interest, were issued in anticipation of payment to the School District as appropriated and to be appropriated by the State of Michigan under Section 11g(3) of Act 94 (State Aid payments). The School District has pledged and assigned to the bondholder all rights to these State Aid payments as security for the Bond. The note receivable on the Statement of Net Assets is for the future appropriations from the State of Michigan to pay the Durant obligations.

School District of the City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE I—LONG-TERM OBLIGATIONS—Continued

Summary of Long-term Obligations—Continued

The annual requirements of principal and interest to amortize bonded debt, capital leases, equipment loan payable, Education Interconnection and Consortium Financing Agreement, and early retirement incentives outstanding as of June 30, 2006 follows:

Year ending June 30,	Principal	Interest	Total
2007	\$ 670,168	\$ 1,057,794	\$ 1,727,962
2008	707,609	1,019,838	1,727,447
2009	769,838	980,160	1,749,998
2010	943,825	1,008,080	1,951,905
2011	815,257	913,800	1,729,057
2012-2016	4,377,889	4,070,116	8,448,005
2017-2021	5,235,000	3,080,913	8,315,913
2022-2026	6,440,000	1,870,803	8,310,803
2027-2030	4,550,000	413,306	4,963,306
	<u>\$ 24,509,586</u>	<u>\$ 14,414,810</u>	<u>\$ 38,924,396</u>

NOTE J—EMPLOYEE BENEFITS

Employee Retirement System – Defined Benefit Plan

Plan description – The School District contributes to the statewide Michigan Public School Employees' Retirement System (MPERS), a cost sharing multiple-employer defined benefit pension plan administered by the nine member board of the MPERS. The MPERS provides retirement benefits and post-retirement benefits for health, dental and vision. The MPERS was established by Public Act 136 of 1945 and operated under the provisions of Public Act 300 of 1980, as amended. The MPERS issues a publicly available financial report that includes financial statements and required supplementary information for MPERS. That report may be obtained by writing to or calling:

Office of Retirement Systems
Michigan Public School Employees Retirement System
P.O. Box 30171
Lansing Michigan 48909
1-800-381-5111

School District of the City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED

June 30, 2006

NOTE J—EMPLOYEE BENEFITS—Continued

Employee Retirement System – Defined Benefit Plan—Continued

Funding policy – Member Investment Plan (MIP) members enrolled in MIP prior to January 1, 1990 contribute a permanently fixed rate of 3.9 percent of gross wages. The MIP contribution rate was 4.0 percent from January 1, 1987, the effective date of the MIP, until January 1, 1990 when it was reduced to 3.9 percent. Members first hired January 1, 1990 or later and returning members who did not work between January 1, 1987 through December 31, 1989 contribute at the following graduated permanently fixed contribution rate: 3 percent of the first \$5,000; 3.6 percent of \$5,001 through \$15,000; 4.3 percent of all wages over \$15,000.

Basic Plan members make no contributions. For a limited period ending December 31, 1992, an active Basic Plan member could enroll in the MIP by paying the contributions that would have been made had enrollment occurred initially on January 1, 1987 or on the date of hire, plus interest. MIP contributions at the rate of 3.9 percent of gross wages begin at enrollment. Market rate interest is posted to member accounts on July 1st on all MIP monies on deposit for 12 months. If a member leaves MPSERS service and no pension is payable, the member's accumulated contribution plus interest, if any, are refundable.

The School District is required to contribute the full actuarial funding contribution amount to fund pension benefits, plus an additional amount to fund retiree health care benefit amounts on a cash disbursement basis. The rate for the year ended June 30, 2006 was 16.34 percent of payroll. The contribution requirements of plan members and the School District are established and may be amended by the MPSERS Board of Trustees. The School District contributions to MPSERS for the years ended June 30, 2006, 2005 and 2004 were approximately \$2,159,000, \$1,882,000, and \$1,729,000, respectively, and were equal to the required contribution for those years.

The School District is not responsible for the payment of retirement benefits which is the responsibility of the State of Michigan.

Other post-employment benefits – Under the MPSERS Act, all retirees have the option of continuing health, dental and vision coverage.

Post-Retirement Health Care Benefits

Pursuant to employment contracts, certain employees electing early retirement are provided post-retirement health benefits which vary depending on the plan chosen and their age at retirement. Health care benefits terminate the month the person attains eligibility for full social security benefits, or dies, whichever occurs first; however, no more than ten (10) years of payments will be made. The School District records expenditures for these benefits when premiums are due. Future benefits will be funded out of future revenues. The cost of these benefits for the year ended June 30, 2006 was approximately \$590,000 provided to 37 participants.

School District of the City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE K—COMMITMENTS AND CONTINGENCIES

Commitments

- **Operating Leases** – The School District has lease agreements expiring at various dates through September 2010. Expense for the year ended June 30, 2006 was approximately \$51,000. The following is a schedule of future minimum rental payments required under operating leases for School District office equipment.

Year ending June 30,	Amount
2007	\$ 43,916
2008	28,628
2009	9,594
2010	9,594
2011	2,399
	<u>\$ 94,131</u>

The School District conducts a portion of its operations in facilities under a lease agreement expiring June 2007. The lease requires current monthly rentals of \$4,610 and payment of certain occupancy costs by the lessee. Rent expense for the year ended June 30, 2006 was \$55,316.

Contingencies

- **Litigation** – The School District is a defendant in various lawsuits. Although the outcome of these lawsuits is not presently determinable, in the opinion of the School District's legal counsel, the resolution of these matters will not have a material adverse effect on the financial condition of the School District.
- **Federal Programs** – The School District participates in federally-assisted grant programs, which are subject to program compliance audits by the grantor or its representatives. Such audits of these programs may be performed at some future date. The amount, if any, of expenditures which may be disallowed by the granting agencies cannot be determined at this time. The School District has approximately \$148 thousand in questioned costs resulting from the Single Audit of its federal programs for the years ending June 30, 2006 and 2005. Based upon prior experience and audit results, the School District believes it is not likely it will incur significant losses on possible grant disallowances.

School District of the City of Muskegon Heights
NOTES TO FINANCIAL STATEMENTS—CONTINUED

June 30, 2006

NOTE L—OTHER INFORMATION

Economic Dependence – Prior years revision of the State of Michigan (State) school aid formula for local public schools significantly increased State school aid, and the change in property tax laws significantly decreased local property tax revenues. As a result, State school aid represents approximately 68 percent of General Fund revenues.

Risk Management – The School District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; error and omissions; injuries to employees; and natural disasters. The School District participates in two distinct pools of educational institutions within the State of Michigan for self-insuring property and casualty and workers' disability compensation. The pools are considered public entity risk pools. The School District pays annual premiums under a retrospectively rated policy to the pools for the respective insurance coverage. In the event a pool's total claims and expenses for a policy year exceed the total normal annual premiums for said years, all members of the specific pool's policy year may be subject to special assessment to make up the deficiency. The workers' compensation pool and the property casualty pool maintain reinsurance for claims generally in excess of \$500,000 for each occurrence with the overall maximum coverage varying depending on the specific type coverage of reinsurance.

The School District continues to carry commercial insurance for other risks of loss, including employee health and accident insurance. No settlements have occurred in excess of coverage for June 30, 2006 or any of the prior three years.

NOTE M—SUBSEQUENT EVENT

On August 11, 2006, the School District received the proceeds of a \$2,700,000 State of Michigan (state) school aid anticipation note payable. The note payable is not subject to redemption prior to its maturity on August 17, 2007 and bears interest at the rate of 4.5 percent per annum. The School District pledged for payment of the note payable, the amount of state school aid to be received plus the full faith, credit, and resources of the School District.

REQUIRED SUPPLEMENTARY INFORMATION

School District of the City of Muskegon Heights
REQUIRED SUPPLEMENTARY INFORMATION
BUDGETARY COMPARISON SCHEDULE

General Fund

For the year ended June 30, 2006

	Budgeted amounts			Variance with final budget- positive (negative)
	Original	Final	Actual	
REVENUES				
Local sources	\$ 2,053,430	\$ 2,339,284	\$ 3,091,165	\$ 751,881
State sources	18,197,960	17,017,829	16,733,578	(284,251)
Federal sources	4,332,990	6,113,797	5,301,919	(811,878)
Incoming transfers and other transactions	761,580	763,272	698,270	(65,002)
Total revenues	25,345,960	26,234,182	25,824,932	(409,250)
EXPENDITURES				
Instruction				
Basic programs	8,687,210	9,707,090	9,688,086	19,004
Added needs	4,564,740	4,623,910	3,881,794	742,116
Adult and continuing education	205,920	109,860	124,429	(14,569)
Support services				
Pupil	1,675,120	1,772,260	1,761,012	11,248
Instructional staff	1,378,280	2,076,330	2,480,391	(404,061)
General administration	411,910	652,620	587,078	65,542
School administration	1,229,380	1,199,710	1,230,887	(31,177)
Business	509,500	453,850	499,924	(46,074)
Operations and maintenance	2,966,960	3,073,560	3,202,446	(128,886)
Pupil transportation services	882,250	852,780	872,081	(19,301)
Central	636,280	768,240	643,554	124,686
Community services	1,126,410	1,150,440	1,158,930	(8,490)
Outgoing transfers and other transactions	1,072,000	1,027,690	1,070,966	(43,276)
Total expenditures	25,345,960	27,468,340	27,201,578	266,762
Excess (deficiency) of revenues over (under) expenditures	\$ -	\$ (1,234,158)	(1,376,646)	\$ (142,488)
Fund balance at July 1, 2005			476,241	
Fund balance (deficit) at June 30, 2006			\$ (900,405)	

STATISTICAL DATA (Unaudited)

School District of the City of Muskegon Heights
PROPERTY VALUATIONS—HISTORICAL VALUATIONS
 Year ended June 30, 2006
 (Unaudited)

<u>Year</u>	<u>Homestead</u>	<u>Non-homestead¹</u>	<u>Taxable value</u>	<u>Increase (decrease) over prior year</u>
2005	\$ 38,303,925	\$ 82,251,702	\$ 120,555,627	3.2 %
2004	37,387,015	79,448,678	116,835,693	2.2
2003	37,044,912	77,322,645	114,367,557	1.0
2002	35,714,957	77,874,707	113,589,664	2.4
2001	34,198,827	76,732,121	110,930,948	5.0

Source: Muskegon County Equalization Department

¹Includes Industrial Facilities Tax roles

School District of the City of Muskegon Heights
MAJOR TAXPAYERS
 Year ended June 30, 2006
 (Unaudited)

Taxable values as of June 30, 2006:

<u>Taxpayer</u>	<u>Product/service</u>	<u>Taxable value</u>
Consumers Energy	Utility	\$ 5,820,978
Lift Tech International	Hoists, etc	3,749,683
Anderson Global	Industrial patterns	2,119,800
Quality Tool & Stamping	Metal stamping	2,095,911
Tridonn Construction	Construction	1,824,200
Dana Corp	Transmissions, etc.	1,796,100
Versatile Fabrication	Sheet metal fabrication	1,531,762
DTE Energy	Utility	1,335,400
Muskegon Family Care	Health care	1,057,092
American Grease Stick	Break line manufacturing	946,125
		<u>\$ 22,277,051</u>

The taxable values of the above taxpayers represent 18.5 percent of the School District's 2005 taxable value of \$120,555,627.

Source: Muskegon County Equalization Department

School District of the City of Muskegon Heights
SCHOOL DISTRICT TAX RATES
 Year ended June 30, 2006
 (Unaudited)

	Year ended June 30				
	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
Voted	18.0000	18.0000	18.0000	18.0000	18.0000
Debt	<u>12.5000</u>	<u>12.5000</u>	<u>12.5000</u>	<u>12.5000</u>	<u>12.5000</u>
TOTAL HOMESTEAD	12.5000	12.5000	12.5000	12.5000	12.5000
TOTAL NON-HOMESTEAD	30.5000	30.5000	30.5000	30.5000	30.5000

The School District's 18.0 voted mills will expire with the December 1, 2007 levy.

School District of the City of Muskegon Heights
STATE AID SUMMARY—FUNDS FROM STATE SOURCES
Year ended June 30, 2006
(Unaudited)

Year ended June 30	Amount
2006	\$ 16,733,578
2005	17,078,742
2004	17,564,166
2003	18,947,328
2002	19,102,321

School District of the City of Muskegon Heights
OPERATING TAX LEVIES AND COLLECTIONS
 Year ended June 30, 2006
 (Unaudited)

<u>Year ended June 30</u>	<u>Operating tax levy</u>	<u>Collections to March 1 each year</u>		<u>Collections plus funding to June 30 each year</u>	
2006	\$ 1,422,888	\$ 1,231,067	86.52 %	\$ 1,401,664	98.51 %
2005	1,300,076	1,011,318	77.79	1,260,106	96.93
2004	1,236,969	972,009	78.58	1,199,450	96.97
2003	1,266,332	977,148	77.16	1,218,658	96.24
2002	1,381,178	1,005,753	72.82	1,250,531	90.54

School District of the City of Muskegon Heights
LABOR FORCE
 Year ended June 30, 2006
 (Unaudited)

A breakdown of the number of employees of the School District of the City of Muskegon Heights and their affiliation with organized groups is as follows:

<u>Employees</u>	<u>Number</u>	<u>Bargaining unit</u>	<u>Contract expiration</u>
Administrators	13	Teamsters	06/30/06
Teachers	147	MEA-NEA	08/31/06
Secretarial/Clerical	19	MEA-NEA	06/30/03
Instructional Assistants	36	AFSCME	10/15/07
Maintenance/Custodial	24	MEA-NEA	08/16/08
Head Start	14	SEIU	10/30/08
Nonunion	<u>33</u>	N/A	N/A
TOTAL STAFF	<u><u>286</u></u>		

School District of the City of Muskegon Heights

PENSION FUND

Year ended June 30, 2006

(Unaudited)

For the period from October 1, 2005 through September 30, 2006, the School District will pay an amount equal to 16.34 percent of its employees' wages to the Michigan Public School Employees Retirement System (MPERS) which is administered by the State of Michigan. The following were the applicable contribution rates required by law for the periods:

October 1, 2004—September 30, 2005	14.87 %
October 1, 2003—September 30, 2004	12.99
October 1, 2002—September 30, 2003	12.99
October 1, 2001—September 30, 2002	12.17
October 1, 2000—September 30, 2001	12.16

These contributions are required by law. Prior to the 1994/95 school year, the School District paid an amount equal to 5 percent of its employees' wages. The School District's contributions for the past five years are shown below. The School District does not have an unfunded accrued liability under MPERS.

Year ending June 30	Paid to pension fund
2006	\$ 2,159,000
2005	1,882,000
2004	1,729,000
2003	1,861,000
2002	1,669,000

Effective January 1, 1987, members of MPERS may irrevocably elect to contribute a percentage of their gross wages on a tax deferred basis to a "member investment plan" (MIP) which qualifies them for additional benefits. The current contribution rate of 3.9 percent became effective January 1, 1990, representing a change from the previous contribution rate of 4 percent. This option to review and adjust the contribution rate is available to MPERS members, if necessary, every three years. All employees hired after January 1, 1990 will contribute to the plan at a graduated rate of their gross wages. If a member leaves MPERS service before a retirement benefit has vested, the member's accumulated contributions to MIP, plus interest, if any, are refundable.

School District of the City of Muskegon Heights
DEBT STATEMENT—DIRECT DEBT
Year ended June 30, 2006
(Unaudited)

<u>Dated</u>	<u>Purpose</u>	<u>Type</u>	<u>Interest spread</u>	<u>Maturities</u>	<u>Amount outstanding</u>
5/6/99	Building and Site	UTQ	5.50%	05/01/07-09	\$ 1,760,000
2/15/06	Refunding	UTQ	3.25-5%	05/01/09-29	<u>22,030,000</u>
					<u>23,790,000</u>

School District of the City of Muskegon Heights
SCHOOL BOND LOAN FUND (SBLF) PROGRAM
Year ended June 30, 2006
(Unaudited)

As of June 30, 2006, the School District has a School Bond Loan Fund principal balance of \$2,154,843 and interest obligations of \$402,104.

The Bonds are fully qualified as of the date of delivery pursuant to Act 108 of the Public Acts of Michigan, 1961, as amended, enacted pursuant to Article IX, Section 16, of the Michigan Constitution of 1963. Under the terms of said constitutional and statutory provisions, if for any reason the School District will be or is unable to pay the principal and interest on the Bonds when due, the School District shall borrow, and the State of Michigan (State) shall lend to it from the School Bond Loan Fund established by the State, an amount sufficient to enable the School District to make payment. Article IX, Section 16 of the Michigan Constitution, as implemented by Act 112 of the Public Acts of Michigan, 1961, as amended, authorizes the State, without approval of its electors, to borrow from time to time such amounts as shall be required, pledge the State's full faith and credit and issue its notes or bonds therefore, for the purpose of making loans to school districts as provided under such section. Loans to school districts for such purposes are made from the proceeds of such State borrowing.

Complete financial statements of all of the State's funds as included in the State's Comprehensive Annual Financial Report (CAFR) prepared by the State's Department of Management and Budget are available upon request from the Department of Management and Budget, Office of Financial Management, P.O. Box 30026, Lansing, Michigan 48909, telephone (517) 373-1011. The State has agreed to file its CAFR with the Nationally Recognized Securities Information Repositories and the State Information Depository (as described in Rule 15c2-12(b)(5) of the Securities and Exchange Commission) annually, so long as any bonds qualified for participation in the School Bond Loan Fund remain outstanding.

School District of the
City of Muskegon Heights

**SINGLE AUDIT OF FEDERAL
FINANCIAL ASSISTANCE PROGRAMS**

Financial Report and
Independent Auditors' Reports

June 30, 2006

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BRICKLEY DELONG

CERTIFIED PUBLIC ACCOUNTANTS

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

October 27, 2006

Board of Education
School District of the City of Muskegon Heights
Muskegon Heights, Michigan

We have audited the financial statements of the School District of the City of Muskegon Heights as of and for the year ended June 30, 2006 and have issued our report thereon dated October 27, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting


In planning and performing our audit, we considered the School District of the City of Muskegon Heights' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted a matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the School District of the City of Muskegon Heights' ability to initiate, record, process and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described as Finding 2 in Part B of the accompanying Schedule of Findings and Questioned Costs.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above is a material weakness.

Compliance

As part of obtaining reasonable assurance about whether the School District of the City of Muskegon Heights' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed one instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described as Finding 1 in Part B of the accompanying Schedule of Findings and Questioned Costs.

This report is intended solely for the information and use of the Board of Education, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



BRICKLEY DELONG

CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

October 27, 2006

Board of Education
School District of the City of Muskegon Heights
Muskegon Heights, Michigan

Compliance

We have audited the compliance of the School District of the City of Muskegon Heights with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 *Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2006. The School District of the City of Muskegon Heights' major federal programs are identified in the Summary of Auditors' Results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the School District of the City of Muskegon Heights' management. Our responsibility is to express an opinion on the School District of the City of Muskegon Heights' compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the School District of the City of Muskegon Heights' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the School District of the City of Muskegon Heights' compliance with those requirements.

As described in Finding 1 in Part B of the accompanying Schedule of Findings and Questioned Costs, the School District of the City of Muskegon Heights did not comply with requirements regarding Special Tests and Provisions, Highly Qualified Teachers and Paraprofessionals compliance requirement that are applicable to its U.S. Department of Education, Title I, Part A program. Compliance with such requirements is necessary, in our opinion, for the School District of the City of Muskegon Heights to comply with requirements applicable to that program.

Board of Education
October 27, 2006
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In our opinion, except for noncompliance described in the preceding paragraph, the School District of the City of Muskegon Heights complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2006. The results of our auditing procedures also disclosed other instances of noncompliance with federal award program requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described as Findings 3, 4, 5, 6, and 7 in the accompanying Schedule of Findings and Questioned Costs.

Internal Control Over Compliance

The management of the School District of the City of Muskegon Heights is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the School District of the City of Muskegon Heights' internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the School District of the City of Muskegon Heights as of and for the year ended June 30, 2006 and have issued our report thereon dated October 27, 2006. Our audit was performed for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

This report is intended solely for the information and use of the Board of Education, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



School District of the City of Muskegon Heights
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the year ended June 30, 2006

Federal grantor/pass-through grantor/program title	Federal CFDA number	Program or award amount	Accrued (deferred) revenue July 1, 2005	Cash/ payments in kind received (cash basis)	Expenditures (accrual basis)			Accrued (deferred) revenue June 30, 2006	Adjustments	Notes
					Prior year (s)	Current year	Total			
U.S. Department of Education										
Passed through Michigan Department of Education										
Title I	84.010									
031530 0203		\$ 1,509,990	\$ -	\$ (1,827)	\$ 1,509,990	\$ -	\$ 1,509,990	\$ -	\$ (1,827)	5
041530 0405		265,418	15,758	15,758	265,418	-	265,418	-	-	
041550 0405		136,962	4,039	110,772	30,229	106,733	136,962	-	-	
051530 0405		1,809,737	123,829	255,637	1,677,929	131,808	1,809,737	-	-	
051530 0506		268,292	-	213,080	-	268,292	268,292	55,212	-	
051550 0506		195,000	-	121,350	-	169,336	169,336	47,986	-	
061530 0506		2,358,035	-	1,530,150	-	1,870,706	1,870,706	340,556	-	
		<u>6,543,434</u>	<u>143,626</u>	<u>2,244,920</u>	<u>3,483,566</u>	<u>2,546,875</u>	<u>6,030,441</u>	<u>443,754</u>	<u>(1,827)</u>	
Even Start	84.213									
040390 C04110CES		154,596	(5,860)	(4,471)	154,596	-	154,596	-	1,389	6
Title V	84.298									
040250 0405		5,848	1,653	1,653	5,848	-	5,848	-	-	
050250 0405		41,046	626	626	41,046	-	41,046	-	-	
050250 0506		5,758	-	1,200	-	1,200	1,200	-	-	
060250 0506		33,766	-	19,684	-	25,041	25,041	5,357	-	
		<u>86,418</u>	<u>2,279</u>	<u>23,163</u>	<u>46,894</u>	<u>26,241</u>	<u>73,135</u>	<u>5,357</u>	<u>-</u>	
Technology Literacy Challenge	84.318									
054290 0405		35,846	3,450	20,726	18,570	17,276	35,846	-	-	
054290 0506		16,965	-	16,965	-	16,965	16,965	-	-	
064290 0506		43,990	-	27,760	-	29,056	29,056	1,296	-	
		<u>96,801</u>	<u>3,450</u>	<u>65,451</u>	<u>18,570</u>	<u>63,297</u>	<u>81,867</u>	<u>1,296</u>	<u>-</u>	
Reading First	84.357									
062930 0506		628,500	-	496,383	-	609,119	609,119	112,736	-	
Title II A	84.367									
040520 0405		51,362	9,047	9,047	51,362	-	51,362	-	-	
050520 0405		356,881	26,631	29,631	353,881	3,000	356,881	-	-	
050520 0506		19,147	-	18,914	-	19,147	19,147	233	-	
060520 0506		345,346	-	163,340	-	266,747	266,747	103,407	-	
		<u>772,736</u>	<u>35,678</u>	<u>220,932</u>	<u>405,243</u>	<u>288,894</u>	<u>694,137</u>	<u>103,640</u>	<u>-</u>	
Total passed through Michigan Department of Education		8,282,485	179,173	3,046,378	4,108,869	3,534,426	7,643,295	666,783	(438)	

School District of the City of Muskegon Heights
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS—CONTINUED
For the year ended June 30, 2006

Federal grantor/pass-through grantor/program title	Federal CFDA number	Program or award amount	Accrued (deferred) revenue July 1, 2005	Cash/ payments in kind received (cash basis)	Expenditures (accrual basis)			Accrued (deferred) revenue June 30, 2006	Adjustments	Notes
					Prior year (s)	Current year	Total			
<i>U.S. Department of Education—Continued</i>										
Passed through Muskegon Area Intermediate School District										
Adult Basic Education	84.002									
061130 610586		\$ 16,692	\$ -	\$ -	\$ -	\$ 16,692	\$ 16,692	\$ 16,692	\$ -	
Special Education Cluster										
IDEA 101-476 Flowthrough	84.027									
050450 0405		516,203	178,819	225,679	469,343	46,860	516,203	-	-	
060450 0506		553,118	-	438,659	-	497,655	497,655	58,996	-	
		1,069,321	178,819	664,338	469,343	544,515	1,013,858	58,996	-	
IDEA Teacher Mini-grant	84.027	830	-	830	-	830	830	-	-	
IDEA 101-476 Preschool	84.173									
060460 0506		13,371	-	13,371	-	13,371	13,371	-	-	
Total Special Education Cluster		1,083,522	178,819	678,539	469,343	558,716	1,028,059	58,996	-	
Drug Free Schools and Communities Act	84.186									
062860 0606		34,884	-	34,884	-	34,884	34,884	-	-	
Total passed through Muskegon Area Intermediate School District		1,135,098	178,819	713,423	469,343	610,292	1,079,635	75,688	-	
Total U.S. Department of Education		9,417,583	357,992	3,759,801	4,578,212	4,144,718	8,722,930	742,471	(438)	
<i>U.S. Department of Agriculture</i>										
Passed through Michigan Department of Education										
National School Lunch										
Entitlement Commodities	10.550	55,553	-	55,553	-	55,553	55,553	-	-	
Bonus Commodities		2,165	-	2,165	-	2,165	2,165	-	-	
		57,718	-	57,718	-	57,718	57,718	-	-	
051970 Breakfast	10.553	227,511	6,512	34,392	199,631	27,880	227,511	-	-	3
061970 Breakfast		193,356	-	163,176	-	193,356	193,356	30,180	-	3
		420,867	6,512	197,568	199,631	221,236	420,867	30,180	-	
051950 All Lunches	10.555	68,795	1,671	10,959	59,507	9,288	68,795	-	-	3
061950 All Lunches		59,861	-	50,026	-	59,861	59,861	9,835	-	3
051960 Free and Reduced		556,974	13,869	87,705	483,138	73,836	556,974	-	-	3
061960 Free and Reduced		484,842	-	405,808	-	484,842	484,842	79,034	-	3
051980 Snack Program		2,897	-	677	2,220	677	2,897	-	-	3
061980 Snack Program		3,127	-	2,631	-	3,127	3,127	496	-	3
		1,176,496	15,540	557,806	544,865	631,631	1,176,496	89,365	-	

School District of the City of Muskegon Heights
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS—CONTINUED
For the year ended June 30, 2006

Federal grantor/pass-through grantor/program title	Federal CFDA number	Program or award amount	Accrued (deferred) revenue July 1, 2005	Cash/ payments in kind received (cash basis)	Expenditures (accrual basis)			Accrued (deferred) revenue June 30, 2006	Adjustments	Notes
					Prior year (s)	Current year	Total			
<i>U.S. Department of Agriculture—Continued</i>										
Passed through Michigan Department of Education—Continued										
National School Lunch—Continued										
Child Care Food Program										
051920 CCFP Meals	10.558	\$ 7,255	\$ 95	\$ 753	\$ 6,597	\$ 658	\$ 7,255	\$ -	\$ -	
061920 CCFP Meals		10,760	-	7,618	-	10,760	10,760	3,142	-	
062010 Child Care Cash in Lieu		518	-	380	-	518	518	138	-	
		18,533	95	8,751	6,597	11,936	18,533	3,280	-	
Summer Food Service Program for Children										
050900 Summer Food Meals	10.559	128,791	-	128,791	-	128,791	128,791	-	-	3
051900 Summer Food Sponsor Admin		13,305	-	13,305	-	13,305	13,305	-	-	3
060900 Summer Food Meals		20,230	-	-	-	20,230	20,230	20,230	-	3
061900 Summer Food Sponsor Admin		2,090	-	-	-	2,090	2,090	2,090	-	3
		164,416	-	142,096	-	164,416	164,416	22,320	-	
Total passed through Michigan Department of Education and U.S. Department of Agriculture										
		1,838,030	22,147	963,939	751,093	1,086,937	1,838,030	145,145	-	
<i>U.S. Department of Labor</i>										
Passed through County of Muskegon, Michigan										
Wagner Peyser Labor Exchange										
402222/WP-03	17.207	92,743	14,591	14,591	92,743	-	92,743	-	-	
402222/WP-05		37,059	-	27,230	-	37,059	37,059	9,829	-	
		129,802	14,591	41,821	92,743	37,059	129,802	9,829	-	
Workforce Investment Act Cluster										
WIA Adult Program										
402222/WIA-03	17.255	27,665	8,656	8,656	27,665	-	27,665	-	-	
402222/WIA-05		15,081	-	9,689	-	15,081	15,081	5,392	-	
		42,746	8,656	18,345	27,665	15,081	42,746	5,392	-	
WIA Youth Program										
402222/WIA-03	17.259	13,658	3,762	3,762	13,658	-	13,658	-	-	
402222/WIA-05		3,983	-	3,898	-	3,983	3,983	85	-	
		17,641	3,762	7,660	13,658	3,983	17,641	85	-	
WIA Dislocated Workers										
WIA-03	17.260	18,207	-	18,207	-	18,207	18,207	-	-	
Total WIA Cluster		78,594	12,418	44,212	41,323	37,271	78,594	5,477	-	
Total passed through County of Muskegon, Michigan and U.S. Department of Labor										
		208,396	27,009	86,033	134,066	74,330	208,396	15,306	-	

School District of the City of Muskegon Heights
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS—CONTINUED
For the year ended June 30, 2006

Federal grantor/pass-through grantor/program title	Federal CFDA number	Program or award amount	Accrued (deferred) revenue July 1, 2005	Cash/ payments in kind received (cash basis)	Expenditures (accrual basis)			Accrued (deferred) revenue June 30, 2006	Adjustments	Notes
					Prior year (s)	Current year	Total			
<i>U.S. Department of Health and Human Services</i>										
Passed through County of Muskegon, Michigan										
Workfirst	93.558									
402222/WR-04		\$ 160,424	\$ 67,662	\$ 67,662	\$ 160,424	\$ -	\$ 160,424	\$ -	\$ -	
402222/WR-05		133,101	-	133,101	-	133,101	133,101	-	-	
402222/WR-06		200,749	-	108,110	-	200,749	200,749	92,639	-	
		<u>494,274</u>	<u>67,662</u>	<u>308,873</u>	<u>160,424</u>	<u>333,850</u>	<u>494,274</u>	<u>92,639</u>	<u>-</u>	
Passed through Muskegon Area										
Intermediate School District										
Head Start	93.600									
05CH8258/05		602,049	(18,700)	(18,700)	543,873	-	543,873	-	-	
06CH8258/06		625,202	257,942	520,064	363,080	262,122	625,202	-	-	
06CH8258/07		602,152	-	309,028	-	388,857	388,857	79,829	-	
		<u>1,829,403</u>	<u>239,242</u>	<u>810,392</u>	<u>906,953</u>	<u>650,979</u>	<u>1,557,932</u>	<u>79,829</u>	<u>-</u>	
Medical Assistance Program Title XIX	93.778									
393		<u>17,997</u>	<u>-</u>	<u>17,997</u>	<u>-</u>	<u>17,997</u>	<u>17,997</u>	<u>-</u>	<u>-</u>	
Total passed through Muskegon Area										
Intermediate School District		<u>1,847,400</u>	<u>239,242</u>	<u>828,389</u>	<u>906,953</u>	<u>668,976</u>	<u>1,575,929</u>	<u>79,829</u>	<u>-</u>	
Total U.S. Department of Health and Human Services		2,341,674	306,904	1,137,262	1,067,377	1,002,826	2,070,203	172,468	-	
<i>U.S. Department of Homeland Security</i>										
Passed through Michigan State Police										
Homeland Security Grant										
2003 SHSGP, Part II Equipment	97.004	<u>8,672</u>	<u>-</u>	<u>8,672</u>	<u>-</u>	<u>8,672</u>	<u>8,672</u>	<u>-</u>	<u>-</u>	
TOTAL FEDERAL ASSISTANCE		\$ <u>13,814,355</u>	\$ <u>714,052</u>	\$ <u>5,955,707</u>	\$ <u>6,530,748</u>	\$ <u>6,317,483</u>	\$ <u>12,848,231</u>	\$ <u>1,075,390</u>	\$ <u>(438)</u>	

School District of the City of Muskegon Heights
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the year ended June 30, 2006

1. Please see the financial statement footnotes for the significant accounting policies used in preparing this schedule.
2. Management has utilized the Grants Section Auditors Report (Form R7120) in preparing the Schedule of Expenditures of Federal Awards.
3. Child Nutrition Cluster
4. Reconciliation of revenues from federal sources per governmental funds financial statements and expenditures per single audit report schedule of expenditures of federal awards.

Revenues from federal sources per June 30, 2006

Governmental Funds financial statements

General Fund	\$ 5,301,919	
Other governmental funds (includes Food Service Fund)	<u>1,086,937</u>	\$ 6,388,856

Less timing difference due to GASB 33 revenue recognition issues	(71,811)
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Adjustment per note 5 below	1,827
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Adjustment per note 6 below	<u>(1,389)</u>
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Expenditures per single audit report

Schedule of Expenditures of Federal Awards	<u><u>\$ 6,317,483</u></u>
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5. Return of funds to the Michigan Department of Education (MDE) for Title I questioned costs from the June 30, 2004 single audit netted against current year revenue in the financial statements.
6. The June 30, 2005 SEFA showed a deferred revenue of \$5860 due back to MDE. The \$5860 was comprised of the June 30, 2004 single audit questioned costs (\$4471) and unspent grant funds (\$1389). During the June 30, 2006 fiscal year, the \$4471 was returned to MDE. After the June 30, 2004 audit, but prior to submitting the final expenditure report (DS-4044), the School District identified additional program costs and included those costs on the final expenditure report and therefore recognized the \$1389 as current year revenue in the financial statements.

School District of the City of Muskegon Heights
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year ended June 30, 2006

A. SUMMARY OF AUDITORS' RESULTS

1. The auditors' report expresses an unqualified opinion on the financial statements of the School District of the City of Muskegon Heights.
2. **One (1)** reportable condition disclosed during the audit of the financial statements is reported in the Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards* and is reported in Part B of this schedule. These reportable conditions are not reported as material weaknesses.
3. **One (1)** instance of noncompliance material to the financial statements of the School District of the City of Muskegon Heights was disclosed during the audit and is reported in Part B of this schedule.
4. There were **no** reportable conditions disclosed during the audit of the major federal award programs as reported in the Independent Auditors' Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in Accordance with OMB Circular A-133 and as reported in Part C of this schedule.
5. The auditors' report on compliance for the major federal award programs for the School District of the City of Muskegon Heights expresses a qualified opinion.
6. Audit findings that are required to be reported in accordance with Section 510(a) of OMB Circular A-133 are reported in this schedule.
7. The programs tested as major programs were:

<u>Name</u>	<u>CFDA Number</u>
<i>U.S. Department of Agriculture</i> Child Nutrition Cluster	10.553, 10.555 and 10.559
<i>U.S. Department of Education</i> Title I, Part A	84.010
Reading First	84.357
<i>U.S. Department of Health and Human Services</i> Temporary Assistance for Needy Families	93.558

8. The threshold for distinguishing Types A and B programs was \$300,000.
9. The School District of the City of Muskegon Heights was not determined to be a low-risk auditee.

School District of the City of Muskegon Heights
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year ended June 30, 2006

B. FINDINGS RELATING TO THE FINANCIAL STATEMENTS, WHICH ARE REQUIRED TO BE REPORTED IN ACCORDANCE WITH GAGAS

COMPLIANCE

U.S. Department of Education

Fiscal 2006 Finding No. 1: Title I, Part A

Pass-through entity: Michigan Department of Education

CFDA: 84.010

Award Numbers: 061530 0506

Award Year Ends: September 30, 2006

Specific Requirement: Special Tests and Provisions, Highly Qualified Teachers and Paraprofessionals

Criteria: An LEA must ensure that any teacher who is hired after the first day of the 2002-2003 school year to teach a core academic subject and who works in a program supported with Title I, Part A funds is highly qualified as defined in 34 CFR section 200.56. This requirement applies to teachers in Title I targeted assistance programs who teach a core academic subject and are paid with Title I, Part A funds and to all teachers who teach a core academic subject in a Title I schoolwide program school.

Condition: We noted two teachers who were teaching core academic subjects in Title I schoolwide program schools that did not meet the definition of a highly qualified teacher as defined in 34 CFR Section 200.56.

Questioned Costs: \$113,350

Context: We tested all ten teachers who were new hires for the 2005/2006 school year. One new hire was a middle school special education teacher (funded 50/50 with general fund dollars and IDEA federal dollars) who was not certified and was teaching under a substitute permit. We noted a long-term substitute teacher (funded with general fund dollars), who was the teacher of record, who was not certified and was teaching under a substitute permit. There was a similar finding in the June 30, 2005 audit.

Effect: The salaries and benefits for these two employees may have to be returned to either the U.S. Department of Education or the Michigan Department of Education.

Recommendation: The School District should follow their established procedures regarding the hiring of highly qualified teachers.

School District Response: It is the intent of the Human Resources Office of Muskegon Heights Public Schools to follow the established procedures regarding the hiring of highly qualified teachers. The District did not hire the long-term substitute teacher at the beginning of the school year 2005/2006. The long-term substitute had been working toward certification, and it was only after the regular highly qualified teacher had resigned that the long-term substitute was assigned. The long-term substitute was enrolled in a teacher preparation program and working toward teacher certification. It was the understanding that the long-term substitute must be certified by June 30, 2006, or would be terminated. The long-term substitute started prior to the 2002/2003 school year in the Muskegon Heights School District.

The second teacher was hired during the 2005/2006 school year as a special education teacher at the Middle School. The teacher presented proof of a bachelor's degree and master's degree in education from an out-of-state university (Arkansas). It was the belief at the time of hire that with certification in Arkansas, the teacher would be eligible for reciprocity in Michigan to teach for at least one (1) year until taking and passing the MTTC. The assignment outside of the teacher's certified area was a result of posting for a certified special education teacher but not receiving any applicants for the position. The teacher was assigned to the position on a substitute permit basis until which time a certified special education teacher could be hired. The teacher was terminated at the end of the 2005/2006 school year for failure to complete the Michigan Certification requirements under No Child Left Behind.

School District of the City of Muskegon Heights
SCHEDULE OF FINDINGS AND QUESTIONED COSTS—CONTINUED
Year ended June 30, 2006

B. FINDINGS RELATING TO THE FINANCIAL STATEMENTS, WHICH ARE REQUIRED TO BE REPORTED IN ACCORDANCE WITH GAGAS

REPORTABLE CONDITIONS

Fiscal 2006 Finding No. 2: Budgeting Policies and Procedures

Condition: The School District adopted a deficit budget, even though the State School Aid Act (Act 94) of 1979 prohibits deficit (negative equity) budgeting.

Effect: The State of Michigan has remedies under the Act, including withholding funding under the Act until the School District submits to the Michigan Department of Education for approval a budget for the current school fiscal year and a plan to eliminate the School District's deficit not later than the end of the second final year after the deficit was incurred.

Recommendation: The School District should comply with the State School Aid Act (ACT 94) of 1979.

Questioned Costs: None

School District Response: The District submitted an initial deficit reduction plan with the State on June 15, 2006. In October 2006 the District made significant personnel and operational reductions. Currently the 2006/07 budget is being revised, and a modified deficit reduction plan will be submitted to the State.

School District of the City of Muskegon Heights
SCHEDULE OF FINDINGS AND QUESTIONED COSTS—CONTINUED
Year ended June 30, 2006

C. FINDINGS AND QUESTIONED COSTS—MAJOR FEDERAL AWARD PROGRAMS AUDIT

COMPLIANCE

U.S. Department of Agriculture

Fiscal 2006 Finding No. 3: Child Nutrition Cluster

Pass-through entity: Michigan Department of Education

CFDA: 10.553, 10.555, 10.556 and 10.559

Award Numbers: 051970, 069170, 051950, 061950, 051960, 061960, 051980, 061980, 041900 and 042900

Award Year Ends: September 30, 2005 and September 30, 2006

Specific Requirement: Eligibility

Criteria: The School Food Authorities (SFA) must have an approved application or a list of directly certified students on file for each student served a meal or milk that is claimed for federal reimbursement at the free or reduced price rate per USDA Eligibility Guidance for School Meals Manual, August 2001.

Condition: We noted that three applications did not have an eligibility determination indicated on them (two appeared properly recorded on building roster and one was incorrect on building roster), one eligibility determination was incorrect, two applications had correct eligibility determinations, but did not agree to the status on the building roster used for claims/reporting, one application was missing income frequency and staff called parent, but did not document the phone call and one application could not be located.

Questioned Costs: \$277

Context: There were 8 issues in a sample size of 40 students (30 paper applications and 10 direct certifications) selected from the building rosters.

Effect: There were three students receiving reduced price benefits that should have been receiving free lunch benefits, one student receiving free lunch benefits that should have been denied benefits, three students appear to be receiving the proper benefits and one student whose proper benefit could not be determined.

Recommendation: The School District should review the procedures used to process paper applications and provide additional training for staff who process the paper applications.

School District Response: Muskegon Heights Public Schools contracts its food service operations. All procedures have been reviewed by the Management Company and District management, and additional training was provided for contracted food service staff for processing applications. Review of applications will be done throughout the year to ensure accuracy.

School District of the City of Muskegon Heights
SCHEDULE OF FINDINGS AND QUESTIONED COSTS—CONTINUED
Year ended June 30, 2006

C. FINDINGS AND QUESTIONED COSTS—MAJOR FEDERAL AWARD PROGRAMS AUDIT

COMPLIANCE—Continued

U.S. Department of Agriculture

Fiscal 2006 Finding No. 4: Child Nutrition Cluster

Pass-through entity: Michigan Department of Education

CFDA: 10.553, 10.555, 10.556 and 10.559

Award Numbers: 051970, 069170, 051950, 061950, 051960, 061960, 051980, 061980, 041900 and 042900

Award Year Ends: September 30, 2005 and September 30, 2006

Specific Requirement: Reporting

Criteria: All claims for reimbursement must be supported by accurate meal counts and records indicating the number of meals served by category and type per 7 CFR Section 210.7(c).

Condition: We noted that not all claims were supported by accurate meal counts by category and type taken at the point of service.

Questioned Costs: \$61

Context: After reviewing the procedures for counting and recording meals served (buildings have varying procedures and there are three student databases with eligibility status, which don't always agree), we decided to trace numbers from count source documents to the monthly summary used to report meals served. We tested six days for one building and seven days at another building and stopped testing due to the 100% daily error rate we had encountered. These thirteen days were used to calculate the questioned costs.

Effect: The claims for reimbursement filed with the Michigan Department of Education had both over and understatements of meals served by category and type.

Recommendation: The School District should review the procedures used to count, accumulate and report meals served by category and type taken at the point of service to improve the accuracy of the claims for reimbursement.

School District Response: Muskegon Heights Public Schools contracts its food service operations. All procedures for counting and accumulating meals have been reviewed by the Management Company and District management. The District will use the point of service (P.O.S.) system. The reports generated by the P.O.S. system will be used to summarize meals and other reporting purposes.

School District of the City of Muskegon Heights
SCHEDULE OF FINDINGS AND QUESTIONED COSTS—CONTINUED
Year ended June 30, 2006

C. FINDINGS AND QUESTIONED COSTS—MAJOR FEDERAL AWARD PROGRAMS AUDIT

COMPLIANCE—Continued

U.S. Department of Agriculture

Fiscal 2006 Finding No. 5: Child Nutrition Cluster

Pass-through entity: Michigan Department of Education

CFDA: 10.553, 10.555, 10.556 and 10.559

Award Numbers: 051970, 069170, 051950, 061950, 051960, 061960, 051980, 061980, 041900 and 042900

Award Year Ends: September 30, 2006

Specific Requirement: Special Tests and Provisions, Verification of Free and Reduced Price Applications

Criteria: The SFA must report their verification activity and results to their respective State agencies per the September 11, 2003 final rule entitled ‘Determining Eligibility for Free and Reduced Price Meals in Schools – Verification Reporting and Recordkeeping Requirements’.

Condition: We noted that the verification results reported were not accurate and the number of approved applications reported was wrong.

Questioned Costs: None

Context: The number of approved applications reported as Free Eligible based on FS/FIP/FDFIP case numbers was also included in the number of approved applications reported as Free Eligible based on income/household size. The verification results had errors in classification and the applications that reapplied were not reported properly.

Effect: The Michigan Department of Education forwards this information to the Food and Nutrition Service (FNS). This information is used by FNS to make decisions regarding the National School Lunch Program and if the information is inaccurate it may adversely affect those decisions.

Recommendation: The School District should review their verification reporting procedures and provide additional training for staff who perform verification.

School District Response: Muskegon Heights Public Schools contracts its food service operations. All procedures for verification have been reviewed by the Management Company and District management, and additional training has been provided for contracted food service staff. Reports will be reviewed before submission.

School District of the City of Muskegon Heights
SCHEDULE OF FINDINGS AND QUESTIONED COSTS—CONTINUED
Year ended June 30, 2006

C. FINDINGS AND QUESTIONED COSTS—MAJOR FEDERAL AWARD PROGRAMS AUDIT

COMPLIANCE—Continued

U.S. Department of Agriculture

Fiscal 2006 Finding No. 6: Child Nutrition Cluster

Pass-through entity: Michigan Department of Education

CFDA: 10.553, 10.555, 10.556 and 10.559

Award Numbers: 051970, 069170, 051950, 061950, 051960, 061960, 051980, 061980, 041900 and 042900

Award Year Ends: September 30, 2006

Specific Requirement: Special Tests and Provisions, Verification of Free and Reduced Price Applications

Criteria: The SFA must verify the current free and reduced price eligibility of households selected from a sample of applications that it has approved for free and reduced price meals per Circular A-133 Compliance Supplement.

Condition: We noted a) one family was sent a letter indicating a reduction in benefits from free to denied for no response, but the building rosters were not updated for all members of the family, b) one family reapplied for benefits after verification terminated their benefits and building rosters were not properly updated for all members of the family, and c) two applications that did not have all income sources verified.

Questioned Costs: \$275

Context: The two families whose benefits changed had 2 of 4 students whose benefits were not adjusted correctly on the building rosters. School District personnel indicated they called the parents regarding the two applications that did not have all income sources verified and were told the household no longer had the particular income source, but the School District personnel did not document the follow-up procedures that were performed.

Effect: The verification accomplished the desired results of identifying those who should not be receiving free or reduced lunch benefits, but the School District did not update all the appropriate records to make sure meals were properly recorded and reported.

Recommendation: The School District should review their verification procedures and provide additional training for staff who perform verification.

School District Response: Muskegon Heights Public Schools contracts its food service operations. All procedures have been reviewed by the Management Company and District management. All records will be properly maintained and updated as needed.

School District of the City of Muskegon Heights
SCHEDULE OF FINDINGS AND QUESTIONED COSTS—CONTINUED
Year ended June 30, 2006

C. FINDINGS AND QUESTIONED COSTS—MAJOR FEDERAL AWARD PROGRAMS AUDIT

COMPLIANCE—Continued

U.S. Department of Education

Fiscal 2006 Finding No. 7: Title I, Part A

Pass-through entity: Michigan Department of Education

CFDA: 84.010

Award Numbers: 051530 0405, 051530 0506 and 061530 0506

Award Year Ends: June 30, 2005 and September 30, 2006

Specific Requirement: Special Tests and Provisions, Identifying Schools and LEAs Needing Improvement

Criteria: In the case of a school identified for school improvement, the LEA shall, not later than the first day of the school year following such identification, provide all students enrolled in the school with the option to transfer to another public school per Title I, Part A, Section 1116(b)(1)(E) of the Elementary and Secondary Education Act of 1965 as amended by the No Child Left Behind Act of 2001.

Condition: The school district did not provide the option to transfer to another public school by the first day of the school year. We noted letters dated September 2005 sent to parents regarding the option to transfer. The school district also held a parent information night on October 3, 2005 at which they discussed the option to transfer. The first day of school was August 29, 2005.

Questioned Costs: Not determinable.

Context: There was a similar finding in the June 30, 2005 audit.

Effect: Eligible parents and/or students who may have wanted to take advantage of the option to transfer may not have been given all the information needed to make an informed or timely decision.

Recommendation: The School District should review the Michigan Department of Education's Adequate Yearly Progress Technical Assistance/Reporting Packet that includes sample notification letters for the transfer option and mail the letters prior to the first day of the school year.

School District Response: The delay in notification in 2005 was inadvertent, due to administrative staff turnover. The District will review the Technical Assistance/Reporting Packet as recommended and will make every effort to comply.

REPORTABLE CONDITIONS

NONE

SUPPLEMENTAL INFORMATION

BRICKLEY DELONG

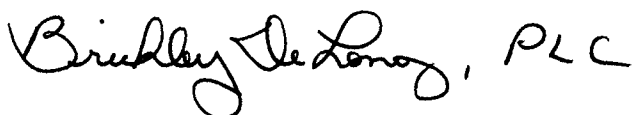
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT ON SUPPLEMENTAL INFORMATION

October 27, 2006

Board of Education
School District of the City of Muskegon Heights
Muskegon Heights, Michigan

We have audited the financial statements of the School District of the City of Muskegon Heights as of and for the year ended June 30, 2006 and have issued our report thereon dated October 27, 2006. Our audit was made primarily for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental information presented on page 21 is provided for purposes of additional analysis and is not a required part of the financial statements or the accompanying Schedule of Expenditures of Federal Awards. Such supplemental information has been subjected to the auditing procedures applied in the audit of the financial statements of the School District of the City of Muskegon Heights and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.



School District of the City of Muskegon Heights
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS PROVIDED TO SUBRECIPIENTS
For the year ended June 30, 2006

Pass-through grantee	Federal CFDA number	Pass-through grantor's number	Amount of subrecipient award	Due to (from) subrecipients July 1, 2005	Cash or payments in kind (cash basis)	Expenditures (accrual basis)			Due to (from) subrecipients June 30, 2006
						Prior year (s)	Current year	Total	
<i>21st Century After School Learning Centers</i>	84.287B	S287B011691-03							
Onekema Consolidated Schools			\$ 138,116	\$ 4,613	\$ 4,613	\$ 138,116	\$ -	\$ 138,116	\$ -
Manistee Area Public Schools			<u>174,751</u>	<u>81,866</u>	<u>81,866</u>	<u>169,179</u>	<u>-</u>	<u>169,179</u>	<u>-</u>
Total subrecipient amounts			<u>\$ 312,867</u>	<u>\$ 86,479</u>	<u>\$ 86,479</u>	<u>\$ 307,295</u>	<u>-</u>	<u>\$ 307,295</u>	<u>\$ -</u>
School District of the City of Muskegon Heights							<u>-</u>		
Total expenditures appearing on Schedule of Expenditures of Federal Awards							<u>\$ -</u>		

CLIENT DOCUMENTS

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

October 27, 2006

Michigan Department of Education
Lansing, Michigan

The School District of the City of Muskegon Heights respectfully submits the following summary of the current status of prior audit findings contained in the single audit report for the year ended June 30, 2005 dated November 9, 2005.

B. FINDINGS—FINANCIAL STATEMENT AUDIT

COMPLIANCE

There were *no* compliance findings in relation to the financial statements.

REPORTABLE CONDITIONS

Fiscal 2005 Finding No. 1: Bank Reconciliation Procedures

Condition: Bank reconciliations were not prepared on a timely basis and are not reviewed and approved by appropriate personnel.

Recommendation: Bank reconciliations should be prepared and reviewed/approved on a timely basis.

Current Status: During the year ended June 30, 2006, the School District implemented this recommendation. *No* similar finding was reported as a result of the single audit for the year ended June 30, 2006.

Fiscal 2005 Finding No. 2: Cash Disbursement Procedures

Condition: During our testing, supporting documentation for three cash disbursements could not be located, four vendor invoices were paid twice, and some vendor invoices were not paid timely causing the School District to pay late fees.

Recommendation: Compliance with existing procedures surrounding cash disbursements should be improved.

Current Status: During the year ended June 30, 2006, the School District implemented this recommendation. *No* similar finding was reported as a result of the single audit for the year ended June 30, 2006.

B. FINDINGS—FINANCIAL STATEMENT AUDIT—Continued

REPORTABLE CONDITIONS—Continued

Fiscal 2005 Finding No. 3: Payroll Recording Procedures

Condition: Payroll expenditures are not always recorded in the general ledger timely.

Recommendation: Payroll expenditures should be recorded in the general ledger accounts in a timely manner.

Current Status: During the year ended June 30, 2006, the School District implemented this recommendation. *No* similar finding was reported as a result of the single audit for the year ended June 30, 2006.

Fiscal 2005 Finding No. 4: General Ledger Account Distribution Procedures

Condition: Various inaccurate general ledger account distributions for health care premiums occurred throughout the year.

Recommendation: The assignment of general ledger account distributions for health insurance premiums should be improved.

Current Status: During the year ended June 30, 2006, the School District implemented this recommendation. *No* similar finding was reported as a result of the single audit for the year ended June 30, 2006.

Fiscal 2005 Finding No. 5: Health Insurance Withholding Procedures

Condition: Payroll withholdings for employee-elected health insurance options were low in relation to amounts disbursed on behalf of employees.

Recommendation: Payroll withholding computations for employee-elected health insurance obligations should be reviewed.

Current Status: During the year ended June 30, 2006, the School District implemented this recommendation. *No* similar finding was reported as a result of the single audit for the year ended June 30, 2006.

C. FINDINGS AND QUESTIONED COSTS—MAJOR FEDERAL AWARD PROGRAMS

COMPLIANCE

U.S. Department of Agriculture

Fiscal 2005 Finding No. 6: Reporting

Child Nutrition Cluster

CFDA: 10.553, 10.555, 10.556 and 10.559

Award Numbers: 041970, 051970, 041950, 051950, 041960, 051960,
051980, 040900, and 041900

Award Year Ends: September 30, 2004 and September 30, 2005

Condition: During our compliance tests for reporting, we noted that not all claims were supported by accurate meal counts by category and type taken at the point of service.

Recommendation: The School District should review the procedures used to count, accumulate and report meals served by category and type taken at the point of service to improve the accuracy of the claims for reimbursements.

Current Status: See Fiscal 2006 Finding No. 4 for a similar finding reported for the single audit for the year ended June 30, 2006.

U.S. Department of Education

Fiscal 2005 Finding No. 7: Documentation of Employee Time and Effort

Title I, Part A

CFDA: 84.010

Award Numbers: 041530 0405, 051530 0405 and 041530 0304

Award Year Ends: June 30, 2005 and September 30, 2005

Condition: During our compliance tests for Allowable Costs/Cost Principles, we noted three employees did not maintain time and effort distribution records in accordance with OMB Circular A-87 (one pay period per month). They completed three time and effort distribution records - one week per calendar quarter that school was in session. The time and effort distribution records that were prepared do support the wages and benefits charged to Title I.

Recommendation: The School District should require all employees who fall under the OMB Circular A-87 requirements for documenting time charged to and/or used for matching in federal award programs to prepare the required documentation.

Current Status: During the year ended June 30, 2006, the School District implemented this recommendation. *No* similar finding was reported as a result of the single audit for the year ended June 30, 2006.

**C. FINDINGS AND QUESTIONED COSTS—MAJOR FEDERAL AWARD PROGRAMS—
Continued**

COMPLIANCE—Continued

U.S. Department of Education

Fiscal 2005 Finding No. 8: Financial Reporting
Title I, Part A
CFDA: 84.010
Award Number: 041530 0304
Award Year End: September 30, 2004

Condition: During our compliance tests for financial reporting, we noted that the final expenditure report (DS-4044) for the above grant had two function lines which exceeded the budget by greater than 10 percent and had a function line which was not in the approved budget. Per the Michigan Department of Education guidelines, an amended budget is required in these cases. No budget amendments were submitted to the Michigan Department of Education.

Recommendation: The School District should submit a budget amendment to the Michigan Department of Education when it exceeds the approved budget by greater than 10 percent or add a new line item of expenditures.

Current Status: During the year ended June 30, 2006, the School District implemented this recommendation. No similar finding was reported as a result of the single audit for the year ended June 30, 2006.

U.S. Department of Education

Fiscal 2005 Finding No. 9: Highly Qualified Teachers
Title I, Part A
CFDA: 84.010
Award Number: 051530 0405
Award Year End: September 30, 2005

Condition: During our compliance tests for the Special Tests and Provisions of highly qualified teachers, we noted that one special education teacher hired in 2003/2004 did not possess a bachelor's degree, although the teacher did take and pass the Michigan Test for Teacher Certification basic skills test and appropriate subject area examination.

Recommendation: The School District should work with the Michigan Department of Education's Office of Field Services and Office of Professional Preparation and Certification to determine if this teacher is highly qualified.

Current Status: See Fiscal 2006 Finding No. 1 for a similar finding reported for the single audit for the year ended June 30, 2006.

**C. FINDINGS AND QUESTIONED COSTS—MAJOR FEDERAL AWARD PROGRAMS—
Continued**

COMPLIANCE—Continued

U.S. Department of Education

**Fiscal 2005 Finding No. 10: Identifying Schools Needing Improvement
Title I, Part A
CFDA: 84.010
Award Number: 051530 0405
Award Year End: September 30, 2005**

Condition: During our compliance tests for the Special Tests and Provisions of identifying schools needing improvement, we noted that the School District did not contact neighboring school districts about the possibility of middle school students transferring from the School District to a neighboring school district's middle school under the Student Transfer Option.

Recommendation: The School District should contact neighboring school districts to see if they will accept students who want to transfer from the School District's middle school. If another district is willing to accept those students, the School District must inform the parents of those students and provide the transportation of those students who elect to transfer.

Current Status: During the year ended June 30, 2006, the School District implemented this recommendation. No similar finding was reported as a result of the single audit for the year ended June 30, 2006.

U.S. Department of Education

**Fiscal 2005 Finding No. 11: Identifying Schools Needing Improvement
Title I, Part A
CFDA: 84.010
Award Number: 051530 0405
Award Year End: September 30, 2005**

Condition: During our compliance tests for the Special Tests and Provisions of identifying schools needing improvement, we noted that the School District parental letters regarding Public School Choice and Supplemental Educational Services did not contain all the required components and were not provided to parents in a timely manner (by the beginning of the school year).

Recommendation: The School District should review the Michigan Department of Education's Technical Assistance Packet that includes sample notification letters for Public School Choice and Supplemental Educational Services.

Current Status: See Fiscal 2006 Finding No. 7 for a similar finding reported for the single audit for the year ended June 30, 2006.

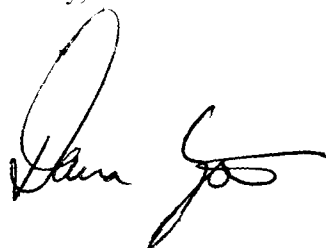
**C. FINDINGS AND QUESTIONED COSTS—MAJOR FEDERAL AWARD PROGRAMS—
Continued**

REPORTABLE CONDITIONS

NONE

There were *no* reportable conditions reported in relation to major federal award programs.

Sincerely,

A handwritten signature in black ink, appearing to read "Dana Bryant", with a stylized flourish at the end.

Dana M. Bryant
Superintendent

CORRECTIVE ACTION PLAN

October 27, 2006

Michigan Department of Education
Lansing, Michigan

The School District of the City of Muskegon Heights respectfully submits the following Corrective Action Plan for the year ended June 30, 2006.

Name and address of independent public accounting firm:

Brickley DeLong, PLC
P.O. Box 999
Muskegon, Michigan 49443

Audit period: June 30, 2006

The findings from the Schedule of Findings and Questioned Costs for the year ended June 30, 2006 are discussed below. The findings are numbered consistently with the numbers assigned in the schedule. Section A of the schedule, Summary of Auditors' Results, does not include findings and is not addressed.

B. FINDINGS—FINANCIAL STATEMENT AUDIT

COMPLIANCE

U.S. Department of Education

Fiscal 2006 Finding No. 1: Title I, Part A

Pass-through entity: Michigan Department of Education

CFDA: 84.010

Award Numbers: 061530 0506

Award Year Ends: September 30, 2006

Specific Requirement: Special Tests and Provisions, Highly Qualified Teachers and Paraprofessionals

Recommendation: The School District should follow their established procedures regarding the hiring of highly qualified teachers.

Action Taken: It is the operating policy of the Human Resources Office to follow established procedures to only hire Highly Qualified Teachers. In the absence of a teacher, the District will submit for MDE permits for any non-Highly Qualified long-term substitute teachers. Executive Director of Human Resources Carrol Wilson will monitor this procedure.

B. FINDINGS—FINANCIAL STATEMENT AUDIT—Continued

REPORTABLE CONDITIONS

Fiscal 2006 Finding No. 2: Budgeting Policies and Procedures

Recommendation: The School District should comply with the State School Aid Act (Act 94) of 1979.

Action Taken: The District began reducing its staff in February 2006, along with closing one of its elementary schools at the end of June 2006. An initial deficit reduction plan was submitted to the State on June 15, 2006. At the beginning of the 2006/07 school year, it was determined that additional budget reductions were necessary. In October 2006 the District made significant personnel and operational reductions. Currently the 2006/07 budget is being revised, and a modified deficit reduction plan will be submitted to the State. This should be completed by November 15, 2006. Superintendent Dana M. Bryant will monitor this process.

C. FINDINGS—MAJOR FEDERAL AWARD PROGRAMS

COMPLIANCE

U.S. Department of Agriculture

Fiscal 2006 Finding No. 3: Child Nutrition Cluster

Pass-through entity: Michigan Department of Education

CFDA: 10.553, 10.555, 10.556 and 10.559

Award Numbers: 051970, 069170, 051950, 061950, 051960, 061960,
051980, 061980, 041900 and 042900

Award Year Ends: September 30, 2005 and September 30, 2006

Specific Requirement: Eligibility

Recommendation: The School District should review the procedures used to process paper applications and provide additional training for staff who process the paper applications.

Action Taken: Muskegon Heights Public Schools contracts its food service operations. All procedures have been reviewed by the Management Company and District management, and additional training was provided for contracted food service staff for processing applications. Review of applications will be done throughout the year to ensure accuracy. Food service Director Charise Johnson and Superintendent Dana M. Bryant will monitor this procedure.

**C. FINDINGS AND QUESTIONED COSTS—MAJOR FEDERAL AWARD PROGRAMS—
Continued**

COMPLIANCE—Continued

U.S. Department of Agriculture

Fiscal 2006 Finding No. 4: Child Nutrition Cluster

Pass-through entity: Michigan Department of Education

CFDA: 10.553, 10.555, 10.556 and 10.559

Award Numbers: 051970, 069170, 051950, 061950, 051960, 061960,
051980, 061980, 041900 and 042900

Award Year Ends: September 30, 2005 and September 30, 2006

Specific Requirement: Reporting

Recommendation: The School District should review the procedures used to count, accumulate and report meals served by category and type taken at the point of service to improve the accuracy of the claims for reimbursement.

Action Taken: Muskegon Heights Public Schools contracts its food service operations. All procedures for counting and accumulating meals have been reviewed by the Management Company and District management. The District will use the point of service (P.O.S.) system. The reports generated by the P.O.S. system will be used to summarize meals and other reporting purposes. Food service Director Charise Johnson and Superintendent Dana M. Bryant will monitor this procedure.

U.S. Department of Agriculture

Fiscal 2006 Finding No. 5: Child Nutrition Cluster

Pass-through entity: Michigan Department of Education

CFDA: 10.553, 10.555, 10.556 and 10.559

Award Numbers: 051970, 069170, 051950, 061950, 051960, 061960,
051980, 061980, 041900 and 042900

Award Year End: September 30, 2006

Specific Requirement: Special Tests and Provisions, Verification of Free and Reduced Price Applications

Recommendation: The School District should review their verification reporting procedures and provide additional training for staff who perform verification.

Action Taken: Muskegon Heights Public Schools contracts its food service operations. All procedures for verification have been reviewed by the Management Company and District management, and additional training has been provided for contracted food service staff. Reports will be reviewed before submission. Food service Director Charise Johnson and Superintendent Dana M. Bryant will monitor this procedure.

**C. FINDINGS AND QUESTIONED COSTS—MAJOR FEDERAL AWARD PROGRAMS—
Continued**

COMPLIANCE—Continued

U.S. Department of Agriculture

Fiscal 2006 Finding No. 6: Child Nutrition Cluster

Pass-through entity: Michigan Department of Education

CFDA: 10.553, 10.555, 10.556 and 10.559

Award Numbers: 051970, 069170, 051950, 061950, 051960, 061960,
051980, 061980, 041900 and 042900

Award Year End: September 30, 2006

Specific Requirement: Special Tests and Provisions, Verification of Free and Reduced Price Applications

Recommendation: The School District should review their verification reporting procedures and provide additional training for staff who perform verification.

Action Taken: Muskegon Heights Public Schools contracts its food service operations. All procedures have been reviewed by the Management Company and District management. All records will be properly maintained and updated as needed. Food service Director Charise Johnson and Superintendent Dana M. Bryant will monitor this procedure.

U.S. Department of Education

Fiscal 2006 Finding No. 7: Title I, Part A

Pass-through entity: Michigan Department of Education

CFDA: 84.010

Award Numbers: 051530 0405, 051530 0506 and 061530 0506

Award Year Ends: June 30, 2005 and September 30, 2006

Specific Requirement: Special Tests and Provisions, Identifying Schools and LEAs Needing Improvement

Recommendation: The School District should review the Michigan Department of Education's Adequate Yearly Progress Technical Assistance/Reporting Packet that includes sample notification letters for the transfer option and mail the letters prior to the first day of the school year.

Action Taken: The District has reviewed the Technical Assistance/Reporting Packet. For the 2006/07 school year, letters that met all NCLB requirements were mailed in a timely manner.

Michigan Department of Education

October 27, 2006

Page 5

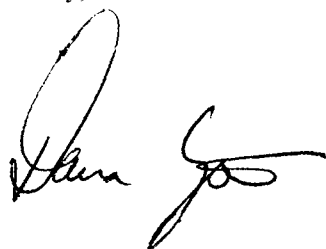
**C. FINDINGS AND QUESTIONED COSTS—MAJOR FEDERAL AWARD PROGRAMS—
Continued**

REPORTABLE CONDITIONS

There were *no* reportable conditions in relation to the major federal award programs.

If the Michigan Department of Education has questions regarding this plan, please call Dana M. Bryant at (231) 830-3220.

Sincerely,

A handwritten signature in black ink, appearing to read 'Dana M. Bryant', with a stylized flourish at the end.

Dana M. Bryant
Superintendent

BRICKLEY DELONG

CERTIFIED PUBLIC ACCOUNTANTS

October 27, 2006

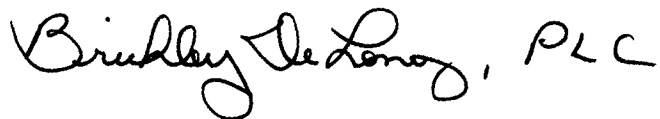
Board of Education
School District of the City of Muskegon Heights
Muskegon Heights, Michigan

In planning and performing our audit of the financial statements of the School District of the City of Muskegon Heights for the year ended June 30, 2006, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control. However, we noted a matter involving internal control and its operation that we consider to be a reportable condition under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect School District of the City of Muskegon Heights's ability to initiate, record, process and report financial data consistent with the assertions of management in the financial statements. We have attached a summary of such reportable condition.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of internal control would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, the reportable condition described above is not believed to be a material weakness.

This report is intended solely for the information of the Board of Education, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



REPORTABLE CONDITIONS

Recommendation 1: The School District should comply with the State School Aid Act (Act 94) of 1979.

The State School Aid Act (Act 94) of 1979 prohibits deficit (negative equity) budgeting. During our audit, we noted that the School District adopted a deficit budget. According to the State School Aid Act:

...A district receiving money under this act shall not adopt or operate under a deficit budget and a district shall not incur an operating deficit in a fund during a school fiscal year (MCL 388.1702)...

...A district having an existing deficit or which incurs a deficit shall not be allotted or paid a further sum under this act until the district submits to the department for approval a budget for the current school fiscal year and a plan to eliminate the district's deficit not later than the end of the second school fiscal year after the deficit was incurred (MCL 388.1702).